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# 85-1610

No. 85-

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1985

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NORTHERN INDIANA PUBLIC SERVICE COMPANY,
*Appellant,*

*v.*

CITIZENS ACTION COALITION OF INDIANA, INC., *et al.*,
*Appellees.*

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*ON APPEAL FROM THE SUPREME COURT OF INDIANA*

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## APPENDIX TO JURISDICTIONAL STATEMENT

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FREDERICK F. EICHHORN, JR.
WILLIAM H. EICHHORN
CHARLES W. WEBSTER
EICHHORN, EICHHORN & LINK
200 Russell Street
P.O. Box 6328
Hammond, Indiana 46325

CHARLES A. HORSKY *
DAVID H. REMES
COVINGTON & BURLING
1201 Pennsylvania Ave., N.W.
P.O. Box 7566
Washington, D.C. 20044
(202) 662-5212

*Attorneys for Northern Indiana Public Service Company*

* Counsel of Record

April 1986

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[1] Obvious typographical errors have been corrected.

**APPENDIX A**

IN THE
SUPREME COURT OF INDIANA

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No. 1185 S 470

CITIZENS ACTION COALITION OF INDIANA, INC.; CITY OF GARY, INDIANA; BAILLY ALLIANCE,
*Appellants,*

*v.*

NORTHERN INDIANA PUBLIC SERVICE COMPANY; UNITED STATES STEEL CORPORATION; BETHLEHEM STEEL CORPORATION; INLAND STEEL COMPANY; NATIONAL STEEL CORPORATION, MIDWEST STEEL DIVISION; UNION CARBIDE INCORPORATED; JONES & LAUGHLIN STEEL INCORPORATED, JONES & LAUGHLIN STEEL CORPORATION DIVISION; OFFICE OF UTILITY CONSUMER COUNSEL,
*Appellees.*

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APPEAL FROM THE PUBLIC SERVICE COMMISSION OF INDIANA

The Honorable Larry J. Wallace, William W. Montgomery, and Margaret S. Harris, Commissioners.

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DeBRULER, J.—

This case comes to this Court on petition to transfer from the Second District of the Court of Appeals.

*Citizens Action Coalition of Indiana Inc., et al. v. Northern Indiana Public Service Company Inc., et al.* (1984), Ind. App., 472 N.E.2d 938. The Court of Appeals considered the issue of whether or not the Public Service Commission of Indiana (PSCI) acted contrary to law in permitting the Northern Indiana Public Service Company (NIPSCO) to amortize the sunk costs of the cancelled Bailly N-1 project through retail rates. The Court of Appeals reversed the cause and ordered the PSCI to vacate any rate increase occasioned by Bailly N-1. We grant transfer in order to resolve the question presented and other issues raised.

These are the facts pertinent to the issue. In 1970, NIPSCO embarked upon a project to construct a nuclear generating plant designated as Bailly N-1. Because of delays due to litigation, to opposition to licensing provisions involving safety, and to escalating costs, NIPSCO cancelled the project on August 21, 1981, after expending $205,724,170. NIPSCO never completed the Bailly N-1 project, nor did NIPSCO place it into service. The PSCI permitted NIPSCO to amortize $190,746,580.00 through retail rates over a fifteen year period. The pertinent part of the PSCI's order is set forth here:

> We resolve the issue as to whether amortization will be allowed affirmatively. *Indiana utilities are under statutory mandate to serve; "every public utility is required to provide reasonable, adequate service and facilities" (I.C. 8-1-2-4 and 8-1-2-69).* The record in this cause established that in order for a utility to meet its mandate to serve, it must begin construction of coal-fired generating facilities 8 to 10 years in advance of

the need therefor with longer periods for nuclear powered facilities. If, in order to comply with the law, a utility must begin construction of generating projects many years in advance of the need for the power, it is the Commission's responsibility to assure that the risk in doing so is not so great as to discourage the endeavor. In 1971 when Petitioner began its effort to construct Bailly, N-1, nuclear power held great promise for efficient and economic power supply. Over the course of the years, the economic advantages of nuclear generation over other forms of generation began to deteriorate and ultimately the delays resulting from regulatory indecision on the federal level and the changing economics forced the cancellation of Bailly, N-1 in August of 1981. This Commission has previously allowed amortization of costs incurred in abandoned and cancelled projects (Cause No. 32079 Dec. 12, 1979*); (Cause No. 36318 June 10, 1981). The amount of the amortization in prior proceedings was not as great as here, but the principle is the same. *We find that the Petitioner prudently began construction of Bailly, N-1 and that upon its cancellation, it became an extraordinary cost of service loss incurred in an effort to provide energy for the consumers of Petitioner's system. The loss occurred with the cancellation. The Bailly, N-1 project was a reasonable undertaking by Petitioner to meet its duty to serve.* The fact that the project was opposed by some for safety and environmental reasons cannot be given weight in this decision. The site locations, safety, environmental and many other issues were liti-

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* [*Correct date*: Dec. 12, 1969.]

gated in the Construction Permit proceedings, decided in Petitioner's favor by the agency with the jurisdiction to do so, the Nuclear Regulatory Commission (NRC), and reviewed and ultimately approved by the United States Court of Appeals for the Seventh Circuit and the United States Supreme Court.

The allowance of amortization of the Bailly, N-1 costs should not be confused with an allowance of a return on the value of a utility plant which is not used and useful in the utility's service. The Petitioner did not seek to earn a return on its investment in Bailly, N-1 during the period of amortization and no return on the investment will be provided in this order. *The authorized amortization is to permit the Petitioner to recover the sunk costs put forth in a reasonable effort to meet the mandate to serve, which unfortunately failed.*

## STANDARD OF REVIEW

The resolution of the issues in this case depends upon the definition of service in I.C. § 8-1-2-1 and the construction of the other statutes in Title 8 which confer upon the PSCI its rate making authority and power. The construction of Indiana law is particularly the province of this Court.

The Public Service Commission derives its power and authority solely from the statute, and unless a grant of power and authority can be found in the statute it must be concluded that there is none. *Chicago & E.I.R. Co. v. Public Service Commission, et al.* (1943), 221 Ind. 592, 49 N.E.2d 341. An order is presumed valid unless the contrary is clearly apparent. Such

presumption vanishes if the Commission fails to conform "to all relevant statutes, standards, and legal principles." *Illinois-Indiana Cable T.V. Inc. v. Public Service Commission* (1981), Ind. App., 427 N.E.2d 1100, 1105. The standard of review is governed by statute. I.C. § 8-1-3-1 states in pertinent portion:

> "An assignment of errors that the decision, ruling or order of the commission is contrary to law shall be sufficient to present both the sufficiency of the facts found to sustain the decision, ruling or order, and the sufficiency of the evidence to sustain the finding of facts upon which it was rendered."

This statute provides a multiple-tier standard of review. At the first level, the statutory standard requires that the Commission's decision contain specific findings on all the factual determinations material to its ultimate conclusions. *L.S. Ayres & Co. v. Indianapolis Power & Light Co.* (1976), 169 Ind. App. 652, 351 N.E.2d 814, 822. At the second level, the statutory standard requires a reviewing court to inquire whether there is substantial evidence in light of the whole record to support the Commission's findings of basic fact. *L.S. Ayres & Co., supra*, at 822. In addition to determining whether or not the decision, ruling or order of the Commission is supported by specific findings of fact and by sufficient evidence, there is another matter in which this Court may always properly inquire, and that is the question of whether or not the decision, ruling or order is contrary to law. *See Public Service Commission v. City of Indianapolis* (1956), 235 Ind. 70, 131 N.E.2d 308, 312. In other words, did the Commission stay within its jurisdiction and conform to the statutory standards and legal principles involved in producing

its decision, ruling or order. *See Public Service Commission v. City of Indianapolis, supra,* at 313.

I

NIPSCO contends that the amortization of sunk costs of the cancelled Bailly N-1 project is an allowable operating expense. NIPSCO relies on *City of Evansville v. Southern Indiana Gas and Electric Company* (1975), 167 Ind. App. 472, 339 N.E.2d 562, to support this proposition.

> The Commission's primary objective in every rate proceeding is to establish a level of rates and charges sufficient to permit the utility to meet its operating expenses plus a return on investment which will compensate its investors. . . . I.C. 1971, 8-1-2-4 (Burns Code Ed.); *Federal Power Comm'n v. Hope Natural Gas Co.* (1944), 320 U.S. 591, 605, 64 S.Ct. 281, 88 L.Ed. 333. The utility's revenues minus its expenses, exclusive of interest, constitute the earnings or the "return" that is available to be distributed to the utility's investors. Allowable operating costs include all types of operating expenses (*e.g.*, wages, salaries, fuel, maintenance) plus annual charges for depreciation and operating taxes. While the utility may incur any amount of operating expenses it chooses, the Commission is invested with broad discretion to disallow for rate-making purposes any excessive or imprudent expenditures. I.C. 1971, 8-1-2-48 (Burns Code Ed.).

*City of Evansville, supra,* at 568, 569. Consequently, NIPSCO argues that there is not any type or category that is disallowable per se, unless prohibited by I.C. § 8-1-2-6(c) which states:

> In determining the amount of allowable operating expenses of a utility, the commission may not take into consideration or approve any expense for institutional or image building advertising, charitable contributions, or political contributions. [Acts 1913, ch. 76, § 9, p. 167; 1933, ch. 190, § 4, p. 928; 1947, ch. 307, § 1; 1979, P.L. 85, § 1.]

NIPSCO asserts that the determination of whether operating expenses are allowable or not is within the sound discretion of the PSCI and that the PSCI's determination cannot be overturned on appeal unless there is an abuse of that discretion. NIPSCO concludes that, since the PSCI's determination was supported by substantial evidence, the PSCI did not abuse its discretion, and thus the PSCI must be affirmed on appeal.

This argument contains a fundamental flaw. To begin with, utility charges are based upon service. I.C. § 8-1-2-4 states that "The charge made by any public utility for any service rendered or to be rendered either directly or in connection therewith shall be reasonable and just." Service is defined in I.C. § 8-1-2-1:

> 8-1-2-1[54-105]. Definition—Short Title.
>
> "The term 'service' is used in this act in its broadest and most inclusive sense and includes not only the use or accommodation afforded consumers or patrons but also any product or commodity furnished by any public or other utility and the plant, equipment, apparatus, appliances, property and facility employed by any public or

> other utility in performing any service or in furnishing any product or commodity and devoted to the purposes in which such public or other utility is engaged and to the use and accommodation of the public."

Since this definition is no model of statutory draftsmanship, we find it helpful in our analysis to dissect the definition. Upon so doing, we discover three categories of "service" included therein:

(1) The use or accommodation afforded consumers or patrons;

(2) Any product or commodity furnished by the utility; or

(3) The plant, equipment, apparatus, appliances, property, and facility employed by the utility

  (a) in performing any service, or

  (b) in furnishing any product or commodity and devoted

  (a) to the purposes in which such utility is engaged and

  (b) to the use and accommodation of the public.

*Illinois-Indiana Cable T.V. v. Public Service Commission* (1981), Ind. App., 427 N.E.2d 1100, 1109.

The ratemaking process has by statute and longstanding practice included the valuation of that property described in category (3) above which is "used and useful" in order to establish a rate base. The

rate base consists of that utility property employed in providing the public with the service for which rates are charged and constitutes the investment upon which the return is to be earned. *City of Evansville, supra,* at 569. Any allowable operating expense must have a connection to the service rendered before it can be recovered through retail rates. See I.C. § 8-1-2-4. This connection is established when the operating expense is incurred as a result of the process whereby existing "used and useful" property, category (3) above, is employed to produce the product or commodity, category (2) above, or accommodation, category (1) above, rate payers receive. For example, wages, salaries, fuel, maintenance plus annual charges for depreciation and operating taxes. *L.S. Ayres & Co. v. Indianapolis Power & Light* (1976), 169 Ind. App. 652, 351 N.E.2d 814, 819. Here the cancelled Bailly N-1 project is not an operating expense because it was not a result of this process which establishes the requisite connection to service rendered. In fact, the Bailly N-1 project could never be an operating expense. At best, it could have become "used and useful" property which then could have incurred allowable operating expenses. However, such was not the case, as the PSCI specifically found that the Bailly N-1 project was never "used and useful" property. It also must be recognized that the PSCI order did not characterize the cancelled Bailly N-1 project as an operating expense.

II

NIPSCO argues that the PSCI's characterization of the Bailly N-1 project as an extraordinary cost of

service loss is correct. The PSCI found that NIPSCO prudently began construction of Bailly, N-1 and that upon its cancellation, it became an extraordinary cost of service loss incurred in an effort to provide energy for its system. The PSCI characterized the Bailly N-1 project as a reasonable undertaking by NIPSCO to meet its duty to serve.

In essence, the PSCI order has unlawfully expanded the definition of service found in I.C. § 8-1-2-1 as construed by *Illinois-Indiana Cable T.V. v. P.S.C., supra.* The PSCI order places an additional charge on consumers other than that allowed in I.C. § 8-1-2-4. The additional charge is for reasonable and prudent attempts at service that fail and that provide no benefit to ratepayers.

Service commences with and includes "used and useful" property. Without "used and useful" property there cannot be any service. I.C. § 8-1-2-1, by defining service in such a manner as to render it dependent on "used and useful" property, is promoting a clear delineation and balance of investor and consumer responsibilities. In the competitive market, investors contribute capital which is employed to produce a product. Consumers purchase the product, and the purchase price includes a reimbursement for the capital contribution of the investors plus a profit to compensate the investors for the risk they assumed. In the market under consideration here, the utility is granted a monopoly. Utilities are regulated in order to protect the consumers from the abuses of monopoly, *i.e.*, artificially high prices. The statutes which govern the regulation of utilities and which grant the PSCI its authority and power provide a surrogate for competition. *See Public Service Commission v. Indiana*

*Bell Telephone Company* (1955), 235 Ind. 1, 130 N.E.2d 467. I.C. § 8-1-2-1 and I.C. § 8-1-2-4 insure that the responsibilities of utility investors and consumers are commensurate with the responsibilities of investors and consumers in a competitive market.

For example, if an automobile company embarked on a new capital project to build a factory that would produce a new sports car and then, before it ever produced a sportscar, cancelled it, the automobile company would ordinarily be unable to recover the cost from its consumers in a competitive market. This is the case we have here. NIPSCO embarked on a capital project to build a nuclear generating plant and, before it ever produced electricity, NIPSCO cancelled it. The definition of service in I.C. § 8-1-2-1 restricts the scope of includable property to that property which performs and furnishes, *i.e.*, producing property or "used and useful" property. *See also Illinois-Indiana Cable T.V.*, *supra*, at 1108-1109. Consequently, I.C. § 8-1-2-1, in conjunction with I.C. § 8-1-2-4, protects consumers from having to pay for service not received, something which they would not be subjected to in a competitive industry. Since Bailly N-1 never became "used and useful" property as I.C. § 8-1-2-1 contemplates, the PSCI's characterization of the cancelled Bailly N-1 project as an extraordinary cost of service loss was incorrect and the order allowing amortization was contrary to law. In dealing with and resolving this claim, we have been unable to conceive of a situation on our own in which the consumers could be required to replenish lost capital which had never become "used and useful" property or, in other words, be required to act in aid and support of the utility as an insurer of the investor's risk, unless consumers received an interest in return

which provided an apportunity to earn a return on the capital supplied.

III

NIPSCO and amici curiae, the banks,[1] argue that the PSCI has allowed amortization of cancelled and abandoned plants numerous times over the past seventy years and that the legislature has made no subsequent change in the utility statute in response. Consequently, they claim that this raises a strong presumption of legislative acquiescence and that this Court should defer to the administrative judgment of the PSCI. They further argue that it would be unfair if this Court were to disallow amortization when lenders were entitled to rely on this long standing practice of the PSCI.

> We have consistently recognized that a long adhered to administrative interpretation dating from the legislative enactment, with no subsequent change having been made in the statute involved, raises a presumption of legislative acquiescence which is strongly persuasive upon the courts. *State Board of Tax Commissioners of S. of Ind. v. Carrier Corp.* (1977), 266 Ind. 615, 365 N.E.2d 1385; *Baker v. Compton* (1965), 247 Ind. 39, 211 N.E.2d 162; *Whirlpool Corp. v. State Board of Tax Commissioners* (1975), 167 Ind. App. 216, 338 N.E.2d 501.

*Indiana Department of Revenue, Indiana Gross Income Tax Division v. Glendale-Glenbrook Associates* (1981), Ind., 429 N.E.2d 217; *see also Costanzo v.*

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[1] Merchants National Bank, American Fletcher National Bank, Fort Wayne National Bank, Indiana National Bank.

*Tillinghast* (1932), 287 U.S. 341, 345, 53 S. Ct. 152, 154, 77 L.Ed. 350, 353.

> Although the interpretation placed upon the statute by an administrative agency of the state may not be binding upon this Court if the interpretation is incorrect, such interpretation as has been made and applied in a number of previous adoptions is entitled to considerable weight, not only to insure the stability of adoption proceedings brought pursuant thereto for a number of years, but as evidence of the meaning of the statute to those charged by law and most concerned with its administration. *See State v. Griffin* (1948), 226 Ind. 279, 284, 79 N.E.2d 537, 540.

*Baker v. Compton* (1965), 247 Ind. 39, 211 N.E.2d 162, 164.

NIPSCO and amici cite these cases to establish that the PSCI has adhered to its interpretation of allowing amortization of cancelled and abandoned plants since the enactment of the Spencer-Shively Act in 1913. *Commercial Club v. Terre Haute, I & E Traction Co.* (Ind. Pub. Serv. Comm'n April 27, 1917), Cause No. 317, P.U.R. 1917 D., 743, 747-748; *Owensville Light Co.* (Ind. Pub. Serv. Comm'n, Sept. 29, 1920), Cause No. 5556; *Toner v. Martinsville Gas & Elec. Co.* (Ind. Pub. Serv. Comm'n, April 27, 1923), Cause No. 6959, P.U.R. 1923 E., 69, 71-73; *Indianapolis Railways, Inc.* (Ind. Pub. Serv. Comm'n, May 7, 1953), Cause No. 23408, 382-A, 100 P.U.R. (N.S.) 207, 217; *Indiana & Michigan Elec. Co.*, (Ind. Pub. Serv. Comm'n, September 21, 1978), Cause No. 35251. With the exception of the last case, these

cases establish a long-adhered to administrative interpretation of allowing amortization of abandoned plants, *i.e.*, plants that were "used and useful" property and then retired from service.[2] This is clearly distinguishable from allowing amortization of cancelled plants that never became "used and useful." Allowance of amortization of cancelled plants would encourage uneconomical or unproductive ventures; whereas, allowance for amortization of abandoned or retired plants encourage utilities to remove obsolete plants and property from the ratebase. This treatment also benefits consumers because obsolete and inefficient property is removed from the ratebase.

Nevertheless, the doctrine of legislative acquiescence is an estoppel doctrine designed to protect those who rely on a long standing administrative interpretation. Here, the cases appellant and amici cite do not support a principled basis for reliance in light of the unique circumstances that the Bailly N-1 cancellation presents.

IV

We also address the issue that forms the basis of the dissent in the opinion of the Court of Appeals. Whether or not the Bailey N-1 project qualifies as an accommodation aspect of service as contemplated by I.C. § 8-1-2-1.

The dissent claims that "accommodation" in I.C. § 8-1-2-1 should be defined as it is in *Webster's Third New International Dictionary* 12 (1976) because the specialized legal meaning derived from commercial

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[2] We do not believe that the I & M case is sufficient by itself to establish a long-adhered to administrative interpretation. Also, the magnitude of the amortization in the I & M case is not comparable with the Bailly N-1.

paper practices is inapposite to construction of the statute. The dissent asserts that the applicable definition is "something that is supplied for convenience or to satisfy a need." As a result, the dissent found that if this definition of accommodation is construed in its "broadest and most inclusive sense" (language taken from I.C. § 8-1-2-1) most of the Bailly N-1 costs are recoverable through amortization from the consumers.

This analysis is flawed in several respects. First, it is the term "service," not the term "accommodation," which is to be interpreted in its "broadest and most inclusive sense" in I.C. § 8-1-2-1. Second, the term "accommodation" has a specific legal meaning in the context of public utility regulation.

The Railroad Commission law, Ind. Acts 1905, Chapter 53, and Ind. Acts 1907, use the term accommodation in the following manner.

> The power and authority is hereby vested in the railroad commission [public service commission] of Indiana, and it is hereby made its duty, as hereinafter provided, to supervise all railroad freight and passenger tariffs, and to adopt all necessary rules and regulations to govern car distribution and delivery, *train service and accommodations* . . . [etc.]

IND. STATS. ANNO. 55-101 (Burns Ed. 1949, pages 801, 8110); Acts 1905, Chapter 53, § 3, as amended by Acts 1907, Chapter 241, § 21. Emphasis added.

> 55-904. Passenger violation rules.—In case any passenger on any railroad shall be injured on the platform of a car, . . . in violation of the printed regulations of the company, posted up at the time . . . such company shall not be liable for the

> injury: Provided, Said company, at the time, furnished room inside its passenger cars *sufficient for the proper accommodation of its passengers.*

IND. STATS. ANNO. 55-904; 1 R.S. 1352, Chapter 83, § 32. Emphasis added.

> 55-701. Duty as to running trains.—Every such corporation shall start and run its cars for the transportation of persons and property at regular times, to be fixed by public notice, and *shall furnish sufficient accommodation for the transportation of all such passengers and property* as shall, . . ., offer or be offered for transportation at the place of starting, . . . .

IND. STATS. ANNO. 55-701 (Burns Ed. 1949, p. 919); 1 R.S. 1852, Chapter 83, § 29. Emphasis added.

Statutes which relate to the same thing or general subject matter are *in pari materia* and should be construed together. 26 I.L.E. Statutes § 130; *State v. Gerhardt* (1896), 145 Ind. 439, 44 N.E. 469; *Starr v. City of Gary* (1934), 206 Ind. 196, 188 N.E. 775. The term "accommodation" in the definitional section of the Public Service Commission Act must be read *in pari materia* with the same term in the Railroad Commission law.

A word or phrase which appears in different parts of the statute will be given the same meaning, unless an intention to the contrary clearly appears. 26 I.L.E. Statutes § 117; *City of East Chicago v. State ex rel. Pitzer* (1949), 227 Ind. 241, 84 N.E.2d 588.

Contemporary case-law also uses the term "accommodation" in this precise sense. *Cf. American Express Company v. Southern Indiana Express Co.*

(1906), 167 Ind. 292, 78 N.E. 1021, 1026; *State v. Pittsburg, C.C. & St. L. Railway Company* (1893), 135 Ind. 578, 35 N.E. 700, 701.

This legislative history negatives the artificial construct that attempts to equate statutory "service" provided in the course of normal operations with unsuccessful efforts to provide service in the distant future.[3]

Accommodation, in the sense used in I.C. § 8-1-2-1, is a benefit the consumer receives that is closely related to the product or commodity the consumer purchases. The Bailly N-1 project could not be an accommodation because it did not confer any benefit on the consumer.

It is clearly apparent upon examination of the governing statutory provisions, their purposes, and the standards and legal principles which must guide their application, that the subject order of the PSCI authorizing amortization of the sunk costs of the Bailly N-1 project has been made without statutory authorization. The Public Service Commission of Indiana is therefore ordered to vacate such order.

Pivarnik, J., concurs.

Shepard, J., concurs in majority opinion and also files concurring opinion.

Givan, C.J., dissents with opinion in which Prentice, J. concurs.

Prentice, J., dissents, with opinion in which Givan, C.J., concurs.

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[3] The dissent's analogy to research and development expenditures as an example of expenditures "not actively utilized in operations" is inapt. The cases he relies on involving South California Edison are based on a specific legislative authorization. Cal. Public Utilities Code § 740.

SHEPARD, J., concurring.

While I have joined today in the majority opinion, I find it necessary to add that I believe at least some of the expenses allowed by the Public Service Commission can be affirmed on the basis of legislative acquiescence.

As appellee Northern Indiana Public Service Company (NIPSCO) correctly points out, this Court has recognized that where an administrative interpretation has existed over a long period of time without being reversed through amendment of the statute, the courts should presume that the legislature has acquiesced in the manner in which the agency has interpreted the law. This presumption is said to aid the courts in understanding legislative intent. Although the interpretation placed upon the statute by an administrative agency is not binding upon the courts, it is entitled to considerable weight "as evidence of the meaning of the statute to those charged by law and most concerned with its administration." *Baker v. Compton* (1965), 247 Ind. 39, 42, 211 N.E. 2d 162.

With respect to the case at bar, NIPSCO has cited a number of ratemaking cases under the Public Service Commission Act in which:

> the Commission has consistently interpreted it to permit the inclusion in rates, as an operating expense, of the cost of [a] prudently cancelled plant and the Legislature by not changing the statute has acquiesced in this interpretation.

Appellee's Brief in Support of Petition to Transfer, pp. 54-55. However, as Justice DeBruler has pointed out in writing for the majority, most of the cases

cited by NIPSCO involved plants which were "used and useful" property and then retired from service. To use the cases of "property abandoned or otherwise retired from service" as support for the amortization of nuclear steam supply equipment or turbines is simply putting too much weight on too slender a thread. Since the legislature has repeatedly declined to authorize including in rates those expenses associated with construction work still in progress, it is hard to accept the argument that the legislature has acquiesced in the inclusion of construction expenses for work no longer in progress.

There are some rate cases, though, from which the argument for legislative acquiescence seems to support a part of the expenses approved by the Commission. The most germane of these is *Public Service Company of Indiana* (Ind. Public Service Commission, June 10, 1981, Cause No. 36318). In that case the Commission allowed amortization of $3,595,000 for outside services related to studies of the feasibility of constructing two additional nuclear generating units at its Marble Hill site. The utility decided not to construct the units. The Commission explained its approval as follows:

> The prudence of Petitioner's decision to perform such studies was not challenged, nor was the prudence of its decision not to construct the units, and we find such decisions to have been prudently made. Both the Public and Staff, however, recommend that Petitioner's shareholders be required to pay such costs. The evidence indicated that Petitioner is not seeking any return on its unamortized balance, in effect requiring its shareholders to share in such costs. We note

> that many state commissions when faced with similar abandoned nuclear projects, including the FERC, have allowed amortization of such costs similar to that proposed by Petitioner. We feel that in light of the prudence of Petitioner's actions incurring such costs for the benefit of its ratepayers, such costs should be amortized in the manner recommended by Petitioner.

*Supra*, at 11.

The Commission has also authorized amortization of management studies aimed at making a utility operate more efficiently. *Indiana & Michigan Electric Company* (Ind. Public Service Commission, January 31, 1977, Cause No. 34588). Somewhat farther afield, it has charged ratepayers for the expenses associated with studying a utility's construction program as a part of a rate case. *Public Service Company of Indiana* (Ind. Public Service Commission, January 20, 1983, Cause No. 36818).

These cases seems to approve expenses for studies which are intended to improve the efficiency of the utility on the assumption that there will be gain for the ratepayers as well as for the stockholders. In this respect, they are founded on the same premise as the cases permitting amortization of the remaining basis of plants retired from service. The Commission has concluded that the ratepayers are better off if utilities can retire an inefficient plant early and still recapture their whole investment than if a company could only recapture its investment by continuing to operate an inefficient plant.

Even these cases make only a modest argument for legislative acquiescence, since the General Assembly can only be said to acquiesce if it chooses not to act

*after* the Commission issues a decision. The earliest of these cases is dated 1977 and NIPSCO has been spending money on Bailly N-1 since the late 1960s. Nevertheless, there is a presumption of validity which this Court gives to decisions rendered by the Commission. *Public Service Commission v. City of Indianapolis* (1956), 235 Ind. 70, 131 N.E.2d 308. I conclude that expenses in the nature of planning, analysis, and investigation of the Bailly project, associated with both the decision to build and the decision to cancel, should be declared to be within the Commission's sphere of authority to approve. While this is presumably only a small portion of the $190 million allowed by the Commission, it is still a multi-million dollar proposition, and I would remand to the Commission for a determination of the actual extent of these expenditures.

Unfortunately, this view has not attracted sufficient concurrence to make it an order of the Court, and I have joined the majority in its conclusions on the construction of the Public Service Commission Act.

Finally, I think it is important to re-emphasize that there is nothing in today's action which should be read as meaning that the Court regards the Commission's practice of permitting amortization of the unrecovered basis of plants retired from service as being outside its authority.

[*dissent of Givan, C.J., follows*]

GIVAN, C.J., dissenting.

I respectfully dissent from the majority opinion in this case. Although I concur with Justice Prentice in his dissenting opinion, I feel the necessity of writing a separate dissenting opinion due to the importance of this case. On page two of the majority opinion, they quote the pertinent part of the PSCI's order in this case. For the sake of brevity it will not be repeated here.

The majority opinion claims the order of the PSCI contains a fundamental flaw, in that "to begin with, utility charges are based upon services." The majority then quotes from Ind. Code § 8-1-2-4 which states "[t]he charge made by any public utility for any service rendered or to be rendered either directly or in connection therewith shall be reasonable and just."

At page five of the majority opinion, they quote the statutory definition of service found in Ind. Code § 8-1-2-1. The beginning sentence of which is:

> "The term 'service' is used in this act in its broadest and most inclusive sense and includes not only the use or accommodation afforded consumers or patrons but also any product or commodity furnished by any public or other utility and the plant, equipment, apparatus, appliances, property and facility employed by any public or other utility in performing any service or in furnishing any product or commodity and devoted to the purposes in which such public or other utility is engaged and to the use and accommodation of the public."

As was stated in *City of Evansville v. Southern Indiana Gas and Electric Company* (1975), 167 Ind.

App. 472, 339 N.E.2d 562, the Public Service Commission must establish a rate level sufficient to permit the utility to meet its operating expenses plus a return on investment which will compensate its investors.

There is no question but what the Public Service Commission also has the duty to see that the consuming public is charged a fair rate and that those rates are not fraudulently or carelessly inflated by the utility. However, in order to "render service" any utility must be operated on a sound business basis, otherwise there would be no "service." Any business, whether it be a public utility or a privately operated business for profit, must be entirely paid for by its customers. This is true as to absolutely every capital expense and operating expense, whether it be necessary in the rendering of the service directly or whether it be generated by mistakes made in the operation of the business; such as, automobile accidents, faulty construction of buildings and so forth. If the company is to succeed and to continue to operate, absolutely all of these expenses must be paid by the customer. There is no other source of revenue.

It is extremely naive to say that we will not allow the rate to be increased to cover the expense but will require the shareholders to pay that expense. In making such a decision, the Public Service Commission would raise absolutely no income to be used by the utility. Depriving stockholders of return is not a fund raising operation. If the debts of a corporation are to be paid, they must of necessity be paid by the customers. In the instant case, if the corporation is to continue to operate, it must of course pay its debts.

Those debts must be paid from the income generated by rates.

The Public Service Commission has the authority to reduce the rate to the extent that little or no return could be paid to the investors by way of dividends. Nevertheless, this lack of dividend would produce revenue to pay the debts of the corporation. Absolutely every debt paid must be paid out of revenue generated by rates. If the Service Commission would reduce the rates to the point where no dividends could be paid, then the health of the utility would be gravely impaired. One of the primary duties of the Commission would be neglected, that being the maintenance of a healthy utility company.

The majority opinion uses an example of an automobile company embarking on a new capital project as though in some manner that differed from the nature of the business of a utility. The only difference of a business in the private sector, operating in the open market, and a business such as a utility in the public sector, operating as a monopoly, is the public control over the company. Whether the control of the company be private or public, sound business practices and reality must be observed.

In the example of the automobile company used by the majority, if the company is to survive and continue in business, any of their losses, including a false start on a new capital project, will eventually be paid for by the customer. If that does not occur, then the company will be an unsuccessful operation. If it continues for any prolonged period, the company will be bankrupt. If those persons investing their capital in a business enterprise, whether public or

private, cannot recoup all of their original capital investment and cannot make a reasonable return on their investment, their company will cease to exist.

It does a disservice to the parties to this litigation and to the public generally to engage in semantics which tend to build a false picture that in some manner some of the debts of the corporation will be paid in a manner other than the collection of rates. If the Public Service Commission would reduce the rate to such a low figure that not only stockholders could not get a return on their investment but that not all the debts could be paid, then bankruptcy would result. The creditors of the corporation would become victims of the bankruptcy. The stockholders of course would lose the value of their stock. For the PSCI to so act would be a gross neglect of their duty under the law.

Referring again to the order of the Public Service Commission, as set forth on page two of the majority opinion, I find it to be entirely within the law, entirely lucid and sound in business practice and in fact the only realistic approach to the problem with which they were presented. I go back to the statement made in *State ex rel. Water Company v. Boone Circuit Court* (1974), 261 Ind. 583, 586-87, 307 N.E. 2d 870, 872, where it was stated "[t]his Court has stated many times that rate making is a legislative and not a judicial function. The legislature has seen fit to establish this Public Service Commission for the express purpose of hearing evidence and balancing and weighing the many complicated factors which must be taken into consideration in settling utility rates." I feel that to deviate from this language is

to impinge the Public Service Commission with judicial fiat that is wholly unrealistic and makes their job virtually impossible.

I would set aside the opinion of the Court of Appeals and would affirm the decision of the Public Service Commission in its entirety.

PRENTICE, J., concurs.

[*dissent of Prentice, J., follows*]

PRENTICE, J., dissenting.

I dissent. That hard cases make for bad law has, to me, never been better demonstrated than by the majority decision.

I am unable to distinguish this case from others where utility companies have been permitted to recover their cost of fulfilling their statutory obligations, except upon the basis of the magnitude of the cost in this particular case and the resultant outcry of an uninformed and misinformed, but unfortunately large and vociferous, segment of consumers.

The issue is one of first instance in this State, *i.e.*, who shall bear the cost of a gargantuan misadventure of a utility company occassioned by a good faith and prudent, but nevertheless aborted, endeavor to comply with its statutory mandate to provide "reasonably adequate service and facilities." The majority has chosen to rationalize that, as a matter of law, inasmuch as the expenditures of the company did not produce a physical facility that was productive of electricity (used and useful), they may not be recovered from the rate payers. I see no such constriction in the law.

I do agree with the majority that the Public Service Commission derives its power and authority solely from the statute; but I do not agree, as its opinion seems to imply, that such grant need be so detailed as to leave nothing to the judgment and discretion of the commission. In fact, the generality of the grant of rate making authority is, in and of itself, a grant of broad discretion, without which the commission could not carry out its mission. It is not a mere ministerial or fact finding body.

I see five sections of the statute bearing upon the authority of the commission in fixing electric rates. Ind. Code 8-1-2-4 is the broad general mandate that the rates be "reasonable and just." Ind. Code 8-1-2-6, Ind. Code 8-1-2-19, Ind. Code 8-1-2-23 and Ind. Code 8-1-2-24 are very specific with regard to certain considerations that are either required or precluded from inclusion in rate determinations, without regard to the reasonableness or equity of the matter.

Although administrative boards do not have inherent powers in the sense that courts do, it is implied in all statutes that that which is incidentally necessary to a full exposition of the legislative intent should be upheld as being germane to the law. *Coplay Cement Mfg. Co. v. Public Service Commission* (1921), 271 Pa. 58, 114 A. 649, 16 A.L.R. 1214. In the construction of a grant of powers, it is a general principle of law that where the end is required, the appropriate means are given, and that every grant of power carries with it the use of necessary and lawful means for its effective execution. The broad general grant is that the Public Service Commission shall have the power to fix electric rates that are "reasonable and just," and the necessary and inescapable conclusion is that, except as otherwise expressly provided, the commission is vested with the discretion to determine the reasonableness of such rates. True, there is no express grant of authority to permit an electric company to recover the cost of the misadventure, but neither is there an explicit grant of authority to allow such companies to recover their costs of operation such as labor costs, fuel costs, taxes, losses on uncollectable accounts, management salaries and professional fees. Yet we know that

such costs are allowed, because to allow them is reasonable and just, and to disallow them would be confiscatory and not in furtherance of the public policy authorizing regulated monopolistic public utilities.

Administrative agencies have and should be accorded every power which is indispensable to the powers expressly granted, that is those powers which are necessarily or fairly and reasonably implied as an incident to the powers expressly granted. 1 Am. Jur.2d *Administrative Law*, § 44. Typical is the holding in *Pan American World Airways, Inc. v. United States* (1963), 371 U.S. 296, 83 S.Ct. 476, 9 L.Ed.2d 325, to the effect that the absence of an explicitly included grant in the statutorily authorized power of the administrative agency was no bar to its order of divestiture.

I am also of the opinion that the doctrine of legislative acquiescence is clearly applicable from the allowance by the commission for a period of seventy (70) years, without generating legislative change, of the recovery of costs of the nature allowed in this case.

The majority opinion summarily dismisses the contention that amortization of the loss is allowable under that doctrine by responding that the circumstances presented by the Bailly N-1 cancellation are "unique." There is nothing whatever unique about the Bailly N-1 circumstances that bears upon the issue. Of course the details vary, but the substance is the same. Except in a consideration of what is includable in the rate base, no distinction can be made between costs occasioned by the abandonment of completed facilities that have become valueless because of changed circumstances and the abandonment of partially completed or merely planned facilities that have become valueless because of changed

circumstances. In either event, a loss is sustained as a result of a prudent attempt to serve the best interests of the rate payer.

Under the viewpoint of the majority, a utility that had prudently spent ten-x dollars towards bringing a new facility onto line could complete it and put it into service for one day, notwithstanding that changed circumstances rendered doing so a useless and wasteful act; and, although it could not recover its costs expended subsequent to the time completion became imprudent, it could recover its cost expended to that point. Thus, if the halfway point has been passed, a facility should be completed, regardless of its folly.

The majority has written "Allowance of amortization of cancelled plants would encourage uneconomical or unproductive ventures; whereas, allowance for amortization of abandoned or retired plants encourages utilities to remove obsolete plants and property from the ratebase." The logic of this analysis escapes me. Regardless of when a project is written off as unproductive, the best the company can hope for is to recover the unamortized cost; and this, in many respects, hinges upon the judgment of the commission. It can never make a profit from abandonment; and if the abandonment occurs prior to the time the project costs are placed in the ratebase, as representative of used and useful assets, the extent of the recovery of the loss depends upon the discretion of the commission in determining whether or not the venture was prudently entered upon, prudently continued to the point of cancellation and prudently cancelled.

To allow expenses and extraordinary losses of the nature of those under consideration to be placed in

the ratebase would place a premium upon waste and imprudence, because a profit would be thereby realized upon the funds wasted or lost in the mismanagement. There can be no such inducement, however, in permitting a utility to pass along the base costs incurred in a prudent attempt to improve or preserve the service that the law requires it to render.

The majority holds that operating expenses, to be recoverable through retail rates, must have been incurred through the employment of existing used and useful property. I cannot find this in the statute, but it is of no moment in my analysis. Some confusion has, perhaps, been added by NIPSCO's references to the losses in issue as "expenses." This characterization is, no doubt, logical inasmuch as it seeks to obtain, for the loss, the same treatment accorded to expenses, thus it does fit the die that has been developed by commission usage and custom. I prefer the characterization of the commission: "extraordinary cost."

At this juncture, it need be noted that invested capital and expenses of operating are treated differently in the ratemaking process. It occurs to me that extraordinary losses should be treated as expenses are treated rather than in the manner that capital is treated; and this accords with the position of both NIPSCO and the commission.

Returning to the essence of the statutes and elementary precepts of utility law, we know that the public policy to be served is to permit monopolistic ownership and operation of public utilities because, if properly regulated and supervised, the public will be served better than it would be by our generally preferred free enterprise system. The extent, quality

and cost of the service to be rendered depends upon a balancing of investor interests and consumer interests. The balancing is affected [*sic*] by the State, through its statute requiring the company to furnish "reasonably adequate service and facilities" and its rates to be "reasonable and just" and establishing the commission to regulate and supervise the system. The objective of the system is to obtain, for the public good, the maximum service at the lowest cost.

A substantial factor in any business enterprise is the risk involved. Electric utilities are capital intensive ventures, that is to say that extraordinarily large sums of money are required to be invested for long periods of time, hence the cost of that capital is a far greater factor in the cost of production than in other industries. The cost of capital, whether debt or equity, varies in direct proportion to the risk perceived by the investors. Traditionally, capital in the free market is available to electric utility companies at costs far less than such cost to any other industry, simply because the risk encountered is less. The market for the product is assured, and competition has been eliminated, hence the risks are only those attendant to production efficiency and the determination of what is reasonable and just in the fixing of rates. So long as investor confidence in the integrity of the system is high, capital will be available at the lowest rates possible. If that confidence is diminished, however, utilities will become high risk, rather than low risk, investments, and the return required to induce investment will rise; and if that confidence is lost, such capital will simply not be available.

The majority has displayed an alarming lack of comprehension in its comparison of the losses occasioned by an automobile manufacturer attempting to

bring a new product to market and those sustained by NIPSCO in endeavoring to develop a nuclear powered generating plant. Two very pertinent differences relevant to the reasonable relegation [*sic*] of the losses will be given.

(1) The manufacturer was under no command to furnish a new product, or anything else, for that matter. NIPSCO was.

(2) If successful, the manufacturer would be at liberty to charge the consumer whatever the market would bear, even if profits so excessive as to be obscene could be thereby derived. NIPSCO, if successful would, nevertheless, be constrained to "reasonable and just charges," as determined by the commission.

So the primary beneficiary of a successful venture by the manufacturer is the investor. Whereas, the primary beneficiary of a successful venture by the regulated utility company is the consumer. The utility investor continues to receive what he did before: a reasonable and just return—presumably the same rate of return on invested capital that he was receiving before, with only the amount of the investment being altered. The utility consumer, on the other hand, would receive the benefits of improved service, cheaper service, or both. To expect the investor, with nothing or little to gain, to assume all of the risk and the consumer, with much to gain, to assume none is neither reasonable nor just and is inherently unrealistic.

Under the majority opinion, all risk of new construction falls upon the investor, and it has but little to gain, yet it is literally impossible for an electric

company to fulfill its obligations without expending vast sums for plans and construction necessary for the rendition of services in the future.

The majority opinion barely mentions the statutory duty of utility companies to provide "reasonably adequate services and facilities" and cavalierly proceeds with the observation that utilities are monopolies and subject to regulation. It does not recognize that the duty to serve goes hand in hand with the limitations upon and entitlement to rates that are reasonable and just. Rates that do not permit a profit may, nevertheless, be reasonable under the circumstances. However, rates that do not permit the recovery of costs for service and facilities that are mandated are confiscatory and unlawful.

If electric companies do not plan and build in advance of demand, it is inescapable that eventually the production facilities once "used and useful" will become "used and useless," and service will be inadequate or non-existent. A company that does not plan and build ahead against such eventuality may not be said to be providing service and facilities that are "reasonably adequate."

On writing this dissent, I assume that every dime spent by NIPSCO was spent in a prudent endeavor to comply with the requirement of the law to provide electrical energy that would be required in the foreseeable future to serve its franchised area. I realize that this may not be entirely correct. There may have been some avoidable waste. There may have been some degree of imprudence at some junctures. The commission, however, has found to the contrary, and we are bound by its findings, if they are supported by the evidence heard by the commission. The

majority has said that it does not matter whether the venture was or was not necessary, that it does not matter if the facilities were probably inadequate to fulfill future demands, that it does not matter that NIPSCO was required by law to enter upon and pursue the venture, that it does not matter that everything it did was correct and prudent, and that it does not matter that the rates to be received in the future will not be reasonable and just. All that matters is that the statute contains no explicit provision authorizing the commission to allow recovery of such loss.

Had the commission determined that all or any portion of the loss was the result of imprudence or speculation to capitalize from a potential wholesale market and had disallowed amortization of some portion, or all of the loss, I would vote to affirm its decision, unless it were shown that such determination was not sustained by the facts. That is the law, and in my judgment, under the facts of this case we are limited to a review of the facts to determine if the commission's determination is thereby sustained.

Prudent management is the responsibility of the investor. Infallible management and the production of utopian services at rates that will please the consumers are not.

Not only do I regard the decision of the majority to be in gross error, as a matter of law; I believe the result to be a societal disaster. Capital for utility companies subject to the law of this case will, in my judgment, be available only at extremely high rates—if at all. What have historically been regarded as conservative, low risk securities will become highly

speculative. Capital that is already committed will of course remain invested, because it cannot escape, thus the consumers in the NIPSCO franchise area may, for the present, be benefitted. Nevertheless utility companies cannot continue to provide "reasonably adequate" services without constant infusions of newly committed capital. At risk is the survival of investor-owned public utilities. In my judgment, the prospects for socialization of the industry are good; but the prospects for adequate services at reasonable rates under that system are dim.

I would affirm the Public Service Commission's decision.

GIVAN, C.J., concurs.

**APPENDIX B**

IN THE
SUPREME COURT OF INDIANA

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No. 1185 S 470

CITIZENS ACTION COALITION OF INDIANA, INC.;
CITY OF GARY, INDIANA; BAILLY ALLIANCE,
*Appellants,*

*v.*

NORTHERN INDIANA PUBLIC SERVICE COMPANY;
UNITED STATES STEEL CORPORATION;
BETHLEHEM STEEL CORPORATION;
INLAND STEEL COMPANY;
NATIONAL STEEL CORPORATION,
MIDWEST STEEL DIVISION;
UNION CARBIDE INCORPORATED;
JONES & LAUGHLIN STEEL INCORPORATED,
JONES & LAUGHLIN STEEL CORPORATION DIVISION;
OFFICE OF UTILITY CONSUMER COUNSEL,
*Appellees.*

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ORDER

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The petitions of Northern Indiana Public Service Company for rehearing and for oral argument, together with supporting and opposing briefs, are now submitted to the Court, and the Court upon examination thereof and being duly advised in the premises

does now order, adjudge, and decree that the petitions for rehearing and for argument be, and the same hereby are, denied.

Done at Indianapolis, Indiana, this 3rd day of January, 1986.

/s/ Richard M. Givan
RICHARD M. GIVAN
Chief Justice

Justices DeBruler and Pivarnik vote to deny rehearing.

Shepard, J., joins the decision to deny rehearing, but regards the previous opinions of the Court as providing an adequate basis to uphold an order of the PSC permitting NIPSCO to recover its planning and analysis expenses if such an order is adopted by the Commission.

Justices Givan and Prentice vote to grant rehearing and to affirm the Commission order.

## APPENDIX C

STATE OF INDIANA
PUBLIC SERVICE COMMISSION OF INDIANA

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Cause No. 36689

PETITION OF NORTHERN INDIANA PUBLIC SERVICE COMPANY FOR APPROVAL OF NEW SCHEDULES OF RATES FOR ELECTRIC SERVICE AND REGULATIONS THEREFOR AND FOR APPROVAL OF THE AMORTIZATION OF THE INVESTMENT IN THE TERMINATED NUCLEAR PROJECT, BAILLY, N1, AND TO FIX A TEST YEAR OF 12 MONTHS ENDED SEPTEMBER 30, 1981, AND A CUT-OFF DATE OF SEPTEMBER 30, 1981.

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Approved: September 28, 1982

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INTERVENORS:

City of Fort Wayne, Indiana

City of Hammond, Indiana

Inland Steel Company; National Steel Corporation, Midwest Steel Division; Union Carbide Corporation; Jones & Laughlin Steel Incorporated, Jones & Laughlin Steel Corporation Division

Bailly Alliance

United States Steel Corporation

Bethlehem Steel Corporation

City of Gary, Indiana

Citizens Action Coalition of Indiana

BY THE COMMISSION:

On November 16, 1981, Northern Indiana Public Service Company, an Indiana corporation sometimes referred to herein as "NIPSCO" or "Petitioner," filed its petition for approval of new rates for electric service and for approval of new rules and regulations therefor and for the approval of the amortization of the investment in the terminated nuclear project, Bailly, N-1.

The Commission having investigated the subject matter of the Petition filed herein and having considered all the evidence presented in this cause and being duly advised in the premises finds that:

1. **Statutory Notices and Commission Jurisdiction:**

Due, legal and timely notice of the filing of the Petition in this cause was given and published by Petitioner as required by law; due and timely notice was given by Petitioner to its residential customers pursuant to Commission Rule 16.2(c) and due, legal and timely notice of the prehearing conference and of the commencement of public hearings in this cause were given and published by the Commission as required by law. The Petitioner is a public utility within the meaning of the Public Service Commission Act, as amended, and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana, and the Commission has jurisdiction over the Petitioner and the subject matter of this cause.

2. **Petitioner's Organization and Business:**

Petitioner is a public utility corporation incorporated under the laws of the State of Indiana operating electric and gas properties in thirty

(30) counties in northern Indiana. It has charter authority to engage in the business of supplying electricity and gas to the public and it owns franchises and indeterminate permits authorizing it to transact the business of supplying electric energy and gas to the public in the area it serves in the State of Indiana.

At September 30, 1981, Petitioner supplied electric energy to about 362,000 customers. The electric customers served by Petitioner, by classes, were as follows: residential 322,522; commercial 28,840; industrial 9,596; street and highway lighting 280; other public authorities 539; railroad 1; and resale 21. Service to said 21 resale customers is subject to the jurisdiction of the Federal Energy Regulatory Commission being sales at wholesale for resale to 12 rural electric membership corporations and 9 municipal electric systems.

Petitioner owns, operates, manages and controls plants, property, equipment and facilities which are used and useful and reasonably necessary for the production, purchase, transmission, distribution and sale of electric energy to residential, commercial, industrial, municipal and other consumers in twenty-one (21) counties in northwestern Indiana, namely: Benton, Carroll, DeKalb, Elkhart, Fulton, Jasper, Kosciusko, LaGrange, Lake, LaPorte, Marshall, Newton, Noble, Porter, Pulaski, St. Joseph, Starke, Steuben, Warren, White and Whitley.

3. **Petitioner's Electric Property:**

Petitioner's electric property in service used and useful for the convenience of the public as of September 30, 1981, includes four steam

electric generating stations having a net capability of 2,434,750 kilowatts; eleven (11) fossil-fuel steam generating units, four (4) at Mitchell Station in Gary, Indiana, with a total net capability of 453,000 kilowatts, two (2) at Bailly Station in Porter County, Indiana, with a total net capability of 490,000 kilowatts, three (3) at Michigan City, Indiana, with a total net capability of 588,750 kilowatts and two (2) at Rollin M. Schahfer Station in Jasper County with a net rated capacity of 903,000 kilowatts. Petitioner has hydroelectric generating facilities on the Tippecanoe River in White County, Indiana, near Monticello with a net capability of 10,000 kilowatts. Petitioner's combustion turbine power block at Dean H. Mitchell Station has a total net capability of 52,200 kilowatts, the combustion turbine generating unit at Bailly Station has a net capability of 33,900 kilowatts and the two oil-fired combustion turbine generators at the R. M. Schahfer Station have a combined capability of 155,000 kilowatts. Total combustion turbine capacity at the three generating stations equals 241,100 kilowatts.

By stations the net generating capability is 505,200 kilowatts at Dean H. Mitchell Station; 523,900 kilowatts at Bailly Station; 588,750 kilowatts at Michigan City Station; 1,058,000 kilowatts at Rollin M. Schahfer Station; and 10,000 kilowatts at the hydro stations for a total of 2,685,850 kilowatts.

The Petitioner's transmission system is an inter-connected system, has voltages ranging from 34,500 to 345,000 volts consisting of approximately 2,857 circuit miles of lines of which

1,965 miles are on wood poles, 686 miles on steel towers and steel poles, 11 miles on concrete poles and 13 miles in underground conduits. It is operated as a single integrated system. Petitioner has 280 substations with an aggregate transformer capacity of 16,598,000 KVA. Petitioner's 21-county distribution system consists of approximately 7,670 circuit miles of primary distribution lines operating at various voltages from 2,300 to 12,500 volts. Of approximately 353,300 poles on which the Petitioner has transmission and distribution circuits, about 45,900 poles are owned by other utilities. The Petitioner has distribution transformers having a capacity of approximately 6,617,000 KVA, 394,-500 electric watt-hour meters and approximately 520 circuit miles of underground primary distribution system exclusive of secondary distribution lines and service drops to customers.

4. **Original Cost of Petitioner's Electric Properties:**

In order for the Commission to make a determination of the fair value of Petitioner's property which is actually used and useful and reasonably necessary for the convenience of the public, we will first identify that property and show it at its original cost:

| | |
|---|---|
| Total Electric Utility Plant Per Balance Sheet September 30, 1981 | $1,942,629,336 |
| Less: | |
| Construction Work in Progress | 295,817,936 |
| Plant Held for Future Use | 3,841,369 |
| SO2 Demonstration Plant | 13,964,417 |

| | | |
|---|---|---|
| Add: | | |
| Common Plant Allocated to Electric Operations | | $ 31,721,735 |
| Original Cost of Electric Utility Plant | | 1,660,727,349 |
| Less: Accumulated Depreciation | | 353,274,636 |
| Net Original Cost of Electric Utility Plant | | 1,307,452,713 |
| Less: | | |
| Non-jurisdictional plant (1,307,452,713 x .0630497) | | 82,434,501 |
| Jurisdictional Electric Utility Plant | | 1,225,018,212 |
| Add: | | |
| Materials and Supplies | | 40,996,930 |
| Construction Projects Completed as of December 31, 1981 | (a) | 30,374,347 |
| Electric Production Fuel | (b) | 55,670,812 |
| Working Capital | (c) | -0- |
| Accumulated Deferred Income Taxes | (d) | -0- |
| Unamortized pre-1971 ITC | (d) | -0- |
| Customer Deposits | (e) | -0- |
| Original Cost Rate Base | | $1,352,060,301 |

[*Footnotes*]

(a) The Petitioner proposed to include in the book original cost amount of its jurisdictional electric utility property at the end of the test year the amount of $30,374,347, which amount represents work projects completed on or before December 31, 1981.

The Commission finds that in determining the present fair value of Petitioner's plant, consideration should be given to plant prevailing at the time of the investigation (September 30, 1981) and the costs of such additions to plant which have been placed in service by December 31, 1981. The testimony of E. M. Shorb in this cause established that additions to plant in the

amount of $32,464,140, both jurisdictional and non-jurisdictional, were placed in service prior to December 31, 1981. We find that the jurisdictional cost of these work projects actually completed on or before December 31, 1981, $30,374,-347, should be included in the rate base herein.

(b) The Petitioner proposed that a 70-day supply of coal at the maximum daily burn (MDB), rate, valued at $98,161,675, be included in the rate base. UCC Witness Cattron and Webb testified that a 70-day supply of coal at average daily burn (ADB) would be sufficient; they valued said inventory at $55,670,812 and $57,536,401 respectively.

The level of coal inventory to be allowed in the rate base has been a vigorously contested issue in recent rate cases for investor-owned electric utilities. In this case, as in others which have preceded it, the evidence of record consists only of conclusions of expert witnesses. We are lacking specific technical evidence which might demonstrate better system reliability or efficiency resulting from maintaining more than a 70-day ADB inventory.

Witnesses for the Public, Webb and Cattron, testified that greatest efficiency is achieved when coal is unloaded from coal cars directly onto the conveyor. Mr. Webb further testified that the 143 ADB inventory of coal which Petitioner had on hand at the end of the test year "represents an inefficient use of resources." Further, Mr. Webb testified that since "NIPSCO's power plants are only available to burn coal about 68% of the time, it really doesn't make much sense to have large amounts of coal in inventory."

Petitioner's witness Shorb argued that a 70-day MDB inventory is essential. He stated that EPA regulations require specific coal to be utilized at certain stations which make it necessary to stockpile many different kinds of coal. He did not explain, however, why the need for many different types of coal requires a greater absolute number of days' supply than the need for but a single type of steam coal. He stated that the coal varieties are not interchangeable, which means that an adequate supply of coal must be maintained for each unit. He did not explain why the inability to substitute coal from unit to unit should necessitate any more than a 70-day ADB supply of coal for any unit. Petitioner notes that its large units are not able to operate well at reduced loads and therefore are operated for extended periods at near capacity. It would appear to us that because the 70-day ADB supply is a function of actual use[,] those units that operate at or near capacity would by definition be allowed almost 70 days' MDB if in fact they are using coal at an MDB rate. The Petitioner states that it has long-term contracts which provide little flexibility for delivery variations and therefore little opportunity for build-up in an emergency. The Petitioner provided no evidence of typical emergencies that might arise or which have occurred which would require that Petitioner build its inventory. Petitioner states that its large industrial load is an around-the-clock, seven-days-a-week load under most circumstances. It would appear to the Commission in this situation, again, that the ADB and MDB

supplies would be quite close together. The Petitioner points out that 50 per cent of its coal supply comes from Colorado and Wyoming and that, as a result, there is a great risk of transportation failures caused by weather, equipment break-down or labor unrest. However, Petitioner gave us no examples of problems encountered during the test year or at any other time which have interrupted the flow of coal to the utility. Petitioner cites that its electric load factor is the highest in the state and nearly the highest in the nation. Petitioner did not explain why having a high load factor requires it to maintain a 70-day MDB supply of coal. A high load factor would surely raise the level of an ADB supply of coal compared to other utilities with a lower load factor. Petitioner states that its approved curtailment regulations provide for curtailment when fuel supplies reach the 60-day level, further curtailment at the 50-day level and mandatory curtailment at the 40-day level. Petitioner neglects to explain whether this is ADB or MDB. Petitioner asserts that a 70-day ADB inventory would jeopardize service under the curtailment rules but fails to provide a specific example of a situation wherein curtailment would have occurred but for the fact that Petitioner maintains a 70-day MDB supply of coal. Petitioner points out that its ten large industrial customers employ 50,000 to 60,000 people and that the impact of curtailment on the large industrial customers, their employees, and the economy would be severe. We agree. But we have no evidence that any curtailments would have occurred if the coal inventory had been maintained at a 70-day ADB level. Mr. Shorb

believes that it would be imprudent for the utility to attempt to operate with only a 70-day ADB supply and stated that even if the Commission only allows a 70-day ADB coal supply in the rate base[,] he will still recommend maintenance of a larger coal supply. We believe that in this order we have made clear to the Petitioner the nature of evidence which would be cogent in supporting a coal inventory in the rate base greater than 70-days' ADB.

The Petitioner has failed to provide us with evidence to contradict the assertions of Messrs. Webb and Cattron that a 70-day ADB inventory is adequate for NIPSCO. There is no evidence which demonstrates that maintenance of a 70-day ADB inventory saves money. This Commission must be convinced by specific evidence that maintaining a larger than 70-day ADB inventory will either be most economical for the Petitioner or that it is necessary to maintain reliable and continuous service. No evidence on the record provides the specific data we require. We find that a 70-day ADB coal inventory should be allowed in the Petitioner's rate base. Said inventory should be valued at $55,670,812 as proposed by Witness Cattron; his calculation adjusts the $98,161,675 inventory proposed by Petitioner whereas Mr. Webb's adjustment was made to Petitioner's actual inventory on hand at September 30, 1981. We find Mr. Cattron's method of calculation preferable because it applies specifically to Petitioner's exhibit.

(c) In its Case-in-Chief, Petitioner did not include a working capital allowance in the rate

base. There is no evidence in the record which indicates a need for such inclusion. Staff Accountant Brenner used the FERC formula to calculate working capital of $48,792,956 and included such amount in his computation of the rate base. Petitioner, only in its post-hearing brief, urged that said working capital be included in the rate base. If Petitioner had presented convincing, company-specific evidence in the form of a lead-lag study or some other generally accepted method, or had submitted convincing evidence that the FERC formula approach is a valid one for the Company, this Commission could have found that some amount of working capital would be appropriate in the rate base. However, Petitioner's cost of capital testimony and rate-base testimony assumed no working capital in rate base. Given the record as it stands, we must find that there should be no allowance for working capital.

(d) **Deferred Taxes.** UCC witness Brosch proposed that accumulated deferred income taxes and the unamortized pre-1971 investment tax credit (ITC) be deducted from Petitioner's rate base. In other proceedings the Commission has recognized deferred income taxes and unamortized pre-1971 ITC as rate-payer-provided zero cost capital. The effect of this treatment is to reduce the weighted average cost of capital.

Deferred taxes and unamortized pre-1971 ITC result from normalization of tax benefits and timing differences. The Public did not present evidence to demonstrate that its proposed treatment would be consistent with the concept of

full normalization which has been accepted by this Commission. We therefore reject Mr. Brosch's proposal and will include accumulated deferred income taxes and the unamortized pre-1971 ITC at zero cost in Petitioner's capital structure.

(e) **Customer Deposits.** UCC Witness Brosch proposed the deduction of customer deposits from rate base because said deposits represent a source of low-cost capital to the Petitioner. The Petitioner opposed the treatment based partially on the erroneous assertion that "the Commission has never considered customer deposits to be a long-term source of capital." (Petitioner's proposed order.) On occasion (Indiana Cities Water Corporation, for example), the Commission has included customer deposits in the capital structure at a cost of 6% which is the interest rate which Petitioner is required to pay on said deposits. The Commission will include customer deposits in the capital structure at 6% cost in this cause. The Commission acknowledges that no party to this cause suggested this treatment. We believe, however, that it is correct to recognize customer deposits as a source of capital at 6% interest.

[*End of Footnotes*]

5. **Fair Value Rate Base:**

The Petitioner's property evaluation witness, John E. Daly, testified that the reproduction cost less depreciation of Petitioner's jurisdictional electric property was $2,642,333,123. The Petitioner's independent accounting witness Byron Johnson testified that, based on the GNP-implicit price deflator the historical cost of Petitioner's

electric plant was $2,820,291,275 and the common plant $127,746,739. Mr. E. A. Schroer testified that the fair value of the company's jurisdictional electric plant and facilities used and useful at September 30, 1981, was $2,008,993,079. Said fair value was arrived at by multiplying the book net electric utility plant in service, $1,225,018,212, by 150% and adding to that Petitioner's per book valuations of materials and supplies, electric production fuel, and construction projects which were completed by December 31, 1981. UCC witness Cattron multiplied the same book net electric utility plant in service by 150%. To that he added materials and supplies, electric production fuel and construction projects to be completed; he deducted deferred taxes and investment credits and customer deposits to arrive at his proposed jurisdictional fair value rate base of $1,792,931,660.

I.C. 8-1-2-6 requires the Commission to value all property of every public utility actually used and useful for the convenience of the public at its "fair value." This section of the Code was initially enacted in 1913. In 1933, the Code was amended to provide that fair value be construed as the "current, fair, cash, value." In 1947, this section of the Code was further amended by inserting the words "giving such consideration as the Commission deems appropriate in each case to all bases of evaluation which may be presented or which the Commission is authorized to consider" by the pre-existing provisions of the Act. The words "current" and "cash," which had been inserted in 1933, were deleted. This amendment appears to have been intended to give the Commission more flexibility.

In any event, nothing in the Code gives the Commission any direction as to what is to be done with this "fair value" once determined. It was presumably the intention of the Legislature that the utility should be entitled to earn a return on its investment in property actually used and useful to serve the needs of its ratepayers. This assumption is confirmed by the landmark Supreme Court cases of *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692-93 (1923), and *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). These two cases are far more helpful than anything found in the Indiana statutes as guidelines for the Commission to follow when determining fair and reasonable rates for investor owned utilities.

It is obvious from the *Bluefield* and *Hope* decisions that the Commission's value of the Petitioner's property is significant only to the extent it enables us to determine a reasonable return on such property:

> "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical mangement, to maintain and support its credit and enable it to raise the

money necessary for the proper discharge of its public duties." *Bluefield Water Works and Improvement Co.* v. *Public Service Commission of West Virginia*, 262 U.S. 679, 692-93 (1923).

"The rate making process . . . the fixing of 'just and reasonable' rates, involves a balancing of the investor and consumer interests. . . . [T]he investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock . . . . By that standard the return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital." *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

A valuation of Petitioner's property must be fixed as the initial term in any rate of return equation which we design to satisfy the requirement of Indiana Code 8-1-2-6 and the criteria defined in these landmark Supreme Court decisions.

Because of the ravages of inflation, the utility's useful property, less depreciation, is obviously

worth more than the net original book cost. However, to establish value based on reproduction costs less depreciation or historical costs adjusted by the GNP-implicit price deflator involves the highly unlikely assumption that the utility today has cause to reconstruct its entire system which has in fact evolved over the years. The Petitioner proposed a fair value which lies between net original book cost and the two cost valuations which it presented and which were based on inflation, although it presented no rationale for the number which it chose.

For purposes of determining the revenue requirements of Petitioner in this proceeding we find a fair value of Petitioner's property actually used and useful and reasonably necessary for service to its public to be:

| | |
|---|---|
| Jurisdictional Electric Utility Plant ..... | $1,794,690,911 |
| Materials and Supplies ..... | 40,996,930 |
| Construction Projects Completed as of December 31, 1981 ..... | 30,374,347 |
| Electric Production Fuel ..... | 55,670,812 |
| Fair Value Rate Base ..... | $1,921,733,000 |

This "fair value," while admittedly judgmental, is within the reasonable parameters of the evidence on fair value in this proceeding.

6. **Petitioner's Fair Rate of Return:**

Based upon the *Bluefield* and *Hope* decisions, the following standards and criteria are used to determine a fair rate of return for Petitioner:

1. Return comparable to return on investments in other enterprises having corresponding risks;

2. Return sufficient to assure confidence in the financial integrity of the Company;

3. Return sufficient to maintain and support the Company's credit;

4. Return sufficient to attract capital as reasonably required by the Company.

Evidence on the fair rate of return on common equity was submitted by witness Dr. Langum and Mr. Seligson for the Petitioner and Dr. Lee and Dr. Hubbell for the UCC.

UCC witness Dr. Lee estimated the cost rate of common equity capital for NIPSCO to be 15.78% based on a Discounted Cash Flow Analysis and 18.44% based on a Capital Asset Pricing Model.

By calculating the mean of these two cost rates, Dr. Lee determined a reasonable cost rate of common equity capital for NIPSCO to be 17.11%. He then conducted a Simulative Coverage Test in order to address the question of whether the 17.11% cost rate can be expected to provide sufficient return to NIPSCO to enable it to maintain its credit and to attract capital. It is Dr. Lee's belief that the coverage levels which NIPSCO would achieve if it would earn 17.11% on common equity would be sufficient to maintain Moody's bond rating of Aa and Standard and Poor's rating of A.

UCC witness Dr. Hubbell used the comparative earnings method and the discounted cash flow method to determine the cost of common equity for NIPSCO. As a check on the two basic methods, he also reviewed the Capital Asset Pricing

Model. He concluded that the cost of common equity capital for NIPSCO is 16.4%.

Petitioner's witness Seligson used a risk-premium approach to make his determination that the cost of common equity for NIPSCO was 18.9%. He testified that such a return would produce earnings of $3.19 per share which should drive the market price of NIPSCO's stock up to $18.58 per share which would be 10% above the $16.89 per share book value which existed at September 30, 1981.

Dr. Langum proposed a pro forma capital structure based on his opinion as to the capital structure necessary for Petitioner to regain its AA rating (Standard and Poor's) and the advantageous financing opportunities consequent to such a rating. Based on his in-depth analysis, Dr. Langum determined the cost of equity capital to be 18.8%.

There was no dispute as to the imbedded cost of debt or preferred and preference stock. Nor was the method of computing the cost of post-1970 unamortized investment tax credit disputed.

As the Commission has noted in other proceedings, the cost of capital is not necessarily the sole criterion to be considered by the Commission in determining the fair rate of return to be allowed on the fair value of a public utility's property actually used and useful for the convenience of the public. However, the cost of capital is a significant factor to be weighed by the Commission in determining such a fair rate of return on the fair value of a public utility's property. In this

proceeding we find that a reasonable determination of Petitioner's cost of capital to be considered by the Commission in determining the fair rate of return on the fair value of its property as of September 30, 1981 for purposes of this proceeding is as follows:

| | Total Co. Capitalization | Percent of Total | Cost in % | Weighted average Cost |
|---|---|---|---|---|
| Long Term Debt .. | $1,017,276 | 42.84% | 8.67 | 3.71% |
| Preferred Stock.... | 261,528 | 11.01 | 7.74 | 0.86 |
| Common Equity.... | 777,508 | 32.74 | 17.50 | 5.73 |
| Post-1970 ITC..... | 78,016 | 3.29 | 10.66 | 0.35 |
| Pre-1971 ITC..... | 5,579 | 0.23 | 0 | |
| Deferred Taxes.... | 230,865 | 9.72 | 0 | |
| Customer Deposits ..... | 4,051 | 0.17 | 6.00 | 0.01 |
| Total ..... | $2,374,823 | 100.00% | | 10.66% |

On the basis of the foregoing evidentiary findings and determinations and taking into account the Petitioner's capital structure, the evidence as to its overall cost of capital, its earning experience, present economic conditions including cost of capital, changes in current money market conditions and various other financial factors affecting this Petitioner which are of record herein, the Commission hereby determines that a fair rate of return for Petitioner of 7.5% on a fair value base of $1,921,733,000 (as determined in Finding 5 above) would provide Petitioner's revenue requirements, including capital costs, and satisfy the standards of the *Bluefield* and *Hope* decisions. The Commission therefore finds said rate of return to be reasonable and just to Petitioner and its ratepayers for purposes of these proceedings.

7. **Petitioner's Annual Depreciation Rate:**

In Cause No. 36394, decided September 16, 1981, Petitioner was authorized by this Commission to utilize functional rates which resulted in an annual composite depreciation rate of 3.59% for its electric utility property. The evidence in this cause substantiates Petitioner's continued use of the rates of depreciation authorized in Cause No. 36394.

8. **Amortization of Bailly, N-1 Costs:**

The Petitioner has requested authority to amortize approximately $190,746,580 representing the sunk cost of a cancelled nuclear plant, Bailly, N-1. Petitioner requests authority to amortize these costs over a five-year period and to recover the costs through increased retail rates. Petitioner's witness E. A. Schroer described the Company's decision to build the Bailly, N-1 plant as being an effort to utilize the most economical generation available as of the 1960's and 1970's (Petitioner's Exhibit A). The application for a permit to construct Bailly, N-1 was filed in 1970 and in the eleven years between the application and the termination in August, 1981 only fifteen months were available for construction of the facility due principally to Nuclear Regulatory Commission (NRC) and judicial delays. Mr. Schroer described Petitioner's efforts to minimize costs during the periods of delay and the Company's periodic review of escalating nuclear costs as compared to escalating coal costs. Mr. Schroer testified that cost comparisons between coal and nuclear continued to favor the nuclear alternative if the unit could

be placed in service as late as 1989. His testimony also established that it became apparent that delays beyond a 1989 in-service date would erode the advantage of the nuclear alternative. In August 1981, the Board of Directors cancelled the plant because the 1989 date was no longer achievable. Petitioner's explanation of the delays incident to the construction as being due to regulatory and other delays beyond its control is supported by the NRC Staff evaluation dated July 17, 1981, received in evidence as Petitioner's Exhibit A-6.

Abraham Gerber, Senior Vice-President, National Economic Research Associates, Inc. (Petitioner's Exhibit E) testified that when Petitioner applied for its construction permit for Bailly, N-1 (1970) optimism for nuclear generation was near its peak. Since 1970, the growth of the economy has slowed, the demand for energy has slowed, inflation has been severe, the period for construction of plants has greatly lengthened making them vulnerable to inflation, and interest costs have escalated. All of these factors have led to widespread plant cancellations according to the Gerber testimony. At the time the Bailly, N-1 project was begun there was a significant advantage for the nuclear plant over the coal-fired alternative with significant cost benefits for the consumer. The cost advantage deteriorated over the years until in 1981 it was estimated that the cost advantage would disappear if the plant was not completed by 1989-90 and that completion in 1989 was considered unlikely.

We resolve the issue as to whether amortization will be allowed affirmatively. Indiana utilities are under statutory mandate to serve; "every public utility is required to provide reasonable, adequate service and facilities" (I.C. 8-1-2-4 and 8-1-2-69). The record in this cause established that in order for a utility to meet its mandate to serve, it must begin construction of coal-fired generating facilities 8 to 10 years in advance of the need therefor with longer periods for nuclear powered facilities. If, in order to comply with the law, a utility must begin construction of generating projects many years in advance of the need for the power, it is the Commission's responsibility to assure that the risk in doing so is not so great as to discourage the endeavor. In 1971 when Petitioner began its effort to construct Bailly, N-1, nuclear power held great promise for efficient and economic power supply. Over the course of the years, the economic advantages of nuclear generation over other forms of generation began to deteriorate and ultimately the delays resulting from regulatory indecision on the federal level and the changing economics forced the cancellation of Bailly, N-1 in August of 1981. This Commission has previously allowed amortization of costs incurred in abandoned and cancelled projects (Cause No. 32079 Dec. 12, 1979*); (Cause No. 36318 June 10, 1981). The amount of the amortization in prior proceedings was not as great as here, but the principle is the same. We find that the Petitioner prudently began construction of Bailly, N-1 and that upon its cancellation, it became an extraordinary cost of service loss in-

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* [*Correct date*: Dec. 12, 1969.]

curred in an effort to provide energy for the consumers on Petitioner's system. The loss occurred with the cancellation. The Bailly, N-1 project was a reasonable undertaking by Petitioner to meet its duty to serve. The fact that the project was opposed by some for safety and environmental reasons cannot be given weight in this decision. The site locations, safety, environmental and many other issues were litigated in the Construction Permit proceedings, decided in Petitioner's favor by the agency with the jurisdiction to do so, the Nuclear Regulatory Commission (NRC), and reviewed and ultimately approved by the United States Court of Appeals for the Seventh Circuit and the United States Supreme Court.

The allowance of amortization of the Bailly, N-1 costs should not be confused with an allowance of a return on the value of a utility plant which is not used and useful in the utility's service. The Petitioner did not seek to earn a return on its investment in Bailly, N-1 during the period of amortization and no return on the investment will be provided in this order. The authorized amortization is to permit the Petitioner to recover the sunk costs put forth in a reasonable effort to meet the mandate to serve, which unfortunately failed.

Intervenor Bailly Alliance would apparently disallow amortization because the Petitioner was considering short pilings before the issuance of the construction permit and did not inform the opponents of the plant that short pilings were under consideration. The witness Osann makes

the assertion that if the piling issue had been litigated in the construction permit proceeding the question would have been resolved in two or three months. (Bailly Alliance Exhibit I.) It is difficult for the Commission to find that the witness Osann can speak for the NRC and define the time limits of a hearing on the pile issue. The Osann position is even less probative when contrasted to the NRC official position that no hearings were required on the short pile issue. (Petitioner's Exhibits T and U.) The fact that the Petitioner was considering short piles at a time earlier than its announced decision to install short piles in 1977 is not significant. It is probable that many issues were weighed by those responsible for the construction of the plant. Some changes would be implemented and some discarded as part of the construction process; that the Petitioner was "considering" the short piles issue at a point in time adds nothing to a resolution of this issue. On cross-examination the witness Osann admitted that it would have been impractical to complete the indicator pile program until after the construction permit issued and the excavation was dug. Petitioner's rebuttal witness John W. Dunn (Petitioner's Exhibit S) clearly established that the indicator pile program was required to prove the efficiency of the short pile program and that it could not have been accomplished until the permit was issued and the excavation had been dug. We find the Bailly Alliance position for disallowing amortization of Bailly, N-1 costs to be without merit.

We next consider the amount of the loss to be amortized. Petitioner asserts that its loss is in the sum of $190.75 million. The amount of amortization is challenged by UCC witness Michael Viren who asserts that there should be a reduction in the amount of engineering expense allowed commencing December, 1977. Dr. Viren maintains that because of the presentation to the NRC of a revised pile design in December of 1977, the Company should have anticipated that the pile design would be the subject of "regulatory review and a lengthy and protracted hearing." Dr. Viren's position was *assumed* on what he believed the Company should have known, but he failed to consider what the Petitioner's staff *actually* knew through negotiations with the NRC. Petitioner's witness Dunn testified in rebuttal that the Company was constantly led to believe that the review of the pile proposal was nearly complete; that no hearing would be required on the short pile proposal as confirmed in the NRC Staff pleading dated January 10, 1979, Petitioner's Exhibit T, and the NRC's decision of December, 1979, Petitioner's Exhibit U. It was not until July, 1981, that the pile design issue was ordered to be included in the construction permit extension proceeding by the United States Court of Appeals for the District of Columbia Circuit. We conclude that the Petitioner had no reason to believe that protracted hearings would be necessary for the approval of the pile program and that the NRC assurances were to the contrary.

Dr. Viren would also disallow a portion of the amortization on the basis that NIPSCO should

have terminated the Bailly, N-1 project in December of 1979. He states that his conclusion is based upon the interaction of three factors: (1) NIPSCO's inadequate forecasting; (2) the Company's inability to predict increased regulatory delay; and (3) an inaccurate evaluation of coal-fired generation versus the nuclear generation. It was Dr. Viren's further testimony that no one of the three factors would have been sufficient to cause the termination in 1979 but it was interaction of all three that prompted his conclusion. We find his analysis to be deficient in several particulars. The Petitioner's forecasting methodology and accuracy was similar to that of other electric utilities during this period of time. NIPSCO's forecasting was "State of the Art" and therefore cannot be considered to be inadequate.

We find Dr. Viren's criticism of the Company's inability to predict regulatory delay unwarranted. It became apparent during cross-examination that Dr. Viren was under the mistaken impression that Petitioner could not go forward with construction during the pendency of the construction permit extension proceeding. This is contrary to the regulations of the NRC applicable to construction permit proceedings in that continued construction is permitted while the extension request is pending (10 CFR § 2.109). Additionally, as noted, the assurance of the NRC staff with regard to the short pile design proposal was that no hearings would be necessary and that approval would be forthcoming. We find that the Petitioner did not unreasonably misjudge the regulatory climate based

upon the information available at the time and could not have reasonably expected the decision of the United States Court of Appeals in July, 1981. Dr. Viren also contended that the Petitioner did not properly evaluate the coal-fired versus nuclear alternative in December of 1979. Petitioner did request its consulting engineers, Sargent & Lundy (S&L), to prepare an additional economic review of nuclear versus coal-fired generation, which report was completed in March of 1980. (Petitioner's Exhibit P.) This report again clearly showed an economic advantage to nuclear versus the coal-fired alternative. Dr. Viren was only able to challenge the S&L report by adding an additional $130 million in fixed costs for design changes that he felt could be expected by the in-service date. We find this addition of $130 million to be arbitrary. Petitioner's witness W. W. Brandfron (S&L), who had many years' experience evaluating nuclear plants, stated that he had never seen an increase in fixed costs in the magnitude of $130 million and that the greatest increase in fixed costs he had experienced resulted from the TMI incident and were in the magnitude of $40 million. Unfortunately, S&L was also employed by Petitioner to design Bailly, and its opinion could have been impaired by this. It would have been *more* prudent of Petitioner to have sought the advice of another consultant with nothing to gain by completion of the Bailly project. However, there is nothing in the record to indicate that S&L's opinion was not valid, or that Petitioner was imprudent in seeking and considering S&L's opinion.

The City of Gary witness Gregory Palast advocated that no amount attributable to allowance for funds used during construction (AFUDC) be allowed in the Bailly, N-1 amortization. Witness Palast refers to AFUDC as "anticipated profits." He does not acknowledge that there are two components to AFUDC: the interest component and the equity component. The interest portion of AFUDC represents the interest *paid* on the utility's borrowed funds used to finance construction; the interest expense is charged to the construction work in progress (CWIP) account and included in the total cost of the plant. The equity portion of AFUDC represents the cost of equity capital (which is determined by means of a Commission approved formula). That cost too is charged to the CWIP account. AFUDC is a recognized concept in utility accounting which adds to the cost of the plant the cost of the funds used to build that plant. While there may well be other areas in this order where we would acknowledge that reasonable minds might differ, we believe that to refer to AFUDC as "anticipated profits" is wrong. AFUDC is a means of accounting for the costs of capital. AFUDC is just as much a part of the sunk cost of Bailly, N-1 as are the engineering fees or wages paid to the construction workers. Therefore we reject Mr. Palast's recommendation.

Various proposals with regard to the amortization period for the Bailly, N-1 costs were made. Petitioner proposed a five-year amortization period, presenting essentially two arguments in support of that proposition: (1) an

amortization period longer than 5 years would impair Petitioner's credit rating and (2) Petitioner is not requesting a return on the unamortized portion of the Bailly, N-1 costs.

Witness Viren, for the Utility Consumer Counselor, recommends a 10-year amortization period, which he said was a "compromise" between a 5-year period and a 20-year period. Witness Viren had done no analysis, however, of the specific impacts of a 5, 10 or 20-year period and acknowledged that his recommendation was arbitrary.

The Industrial Intervenors' Witness Coady testified that neither a 10-year period, nor a 15-year period would have a material adverse effect on Petitioner's financial position. Mr. Coady had measured the economic impacts of 5-year, 10-year and 15-year amortization periods upon the Petitioner in terms of the diminution in (a) the present value of the cash to be realized over the period as against the Petitioner's total assets, and (b) cash flow as against the Petitioner's capital requirement for 1982. Industrial Intervenors' Exhibit 2C showed that the diminution in annual cash flow as a result of a 15-year amortization period, rather than a 5-year period, is 2.9% of the Petitioner's forecasted 1982 capital requirements. It also showed that the diminution in the present value of cash to be paid by the Petitioner's ratepayers over a 15-year amortization period is 1.7% of Petitioner's total assets. Industrial Intervenors' Exhibit 2D showed that if a 15-year amortization period,

rather than a 5-year period, is used, the Petitioner's before tax interest coverage would decrease by 3%. With respect to earnings per share, Mr. Coady testified that use of a 15-year period, rather than a 5-year period, would reduce Petitioner's projected 1982 earnings per share by 2.8%, from $1.80 to $1.75.

Witness Palast, for the City of Gary, recommended a 20-year amortization period. He pointed out that had Bailly, N-1 been constructed, the costs would have been recovered by Petitioner over the depreciable life of the plant, presumably 30 years, beginning in 1990 or whenever the plant was placed in service.

Our decision on the length of the period over which the Petitioner should recover its Bailly, N-1 costs requires a balancing of the interests of, and the economic effects upon, both Petitioner and its ratepayers. As far as the ratepayers are concerned, since ultimately they are going to pay all of the Bailly, N-1 costs which we are allowing the Petitioner to recover, the length of the amortization period determines how much they must pay each year during that period. As far as Petitioner is concerned, the question is, how long must it wait to be reimbursed by its ratepayers for the costs of this abandoned project. While a longer period causes Petitioner to lose on the time value of the money to be received by it, we believe that the issue of who suffers the loss on the time value of money should be resolved in favor of the ratepayers, because they are paying for the costs of an abandoned project from which they will derive no benefit. Moreover, it is material to our decision

that the ratepayers will be paying the taxes on the revenues which they will be providing. It is undisputed that the ratepayers will be required to provide $1.24 in additional revenues for every $1 in Bailly, N-1 costs to be recovered because of the taxes on those revenues. Industrial Intervenors' Exhibit 2, pp. 3-4.

Petitioner presented no evidence in support of its asserted conclusion that an amortization period longer than 5 years would adversely affect its credit rating. The evidence presented by the Industrial Intervenors casts doubt upon that and similar conclusions. The Coady analysis showed that neither a 10-year, nor a 15-year period would substantially affect Petitioner's financial condition. The Petitioner did not dispute those conclusions.

We believe that a proper balancing of the interests of Petitioner and its ratepayers requires the use of a 15-year amortization period for the recovery of the jurisdictional amount of the Bailly, N-1 costs allowed to be recovered herein. Such a period will mitigate the rate impact upon the Petitioner's ratepayers, while not affecting materially Petitioner's financial position. A 15-year period is not out of line with the amortization periods used in other jurisdictions where utilities have been allowed to recover costs associated with abandoned projects similar in amounts to the Bailly, N-1 costs involved here.

The Petitioner's reliance upon our decision in last year's Public Service Company of Indiana case, Cause No. 36318, is misplaced. In that case we authorized PSI to use a 5-year amortization

period, but the amount being amortized there was only $3.5 million—less than 2% of the Bailly, N-1 costs. We should note that in Cause No. 32079 we allowed the Petitioner to amortize $5 million in costs connected with its abandoned Lake-of-the-Woods gas storage project. However, we required those costs to be amortized over 10 years.

We also reject Petitioner's argument that a 5-year amortization period is appropriate because Petitioner is not requesting a return on the unamortized portion of its Bailly, N-1 costs. Petitioner implies that it is "giving up" something by not requesting a return on the unamortized costs. Indiana law does not permit Petitioner to earn a return on plant unless it is "actually used and useful." I.C. 8-1-2-6. The contemplated Bailly, N-1 plant will never achieve that status. Petitioner cannot be credited for "giving up" that which it cannot legally obtain.

Having considered the evidence and the arguments advanced, we find that the Petitioner should be allowed to recover over a 15-year amortization period $190,746,580 of its costs incurred in connection with the abandoned Bailly, N-1 project. Said costs should be amortized over a 15-year period commencing with the effective date of this Order. The related deferred income taxes of $69,096,517 should be amortized over 15 years also. The Commission further finds that Petitioner should file for the Commission's approval, at least 30 days prior to the end of said amortization period, new rate schedules which, effective the day after the end of said

amortization period, reduce the Petitioner's rates then in effect in an amount equal to the annual revenues then required to provide for the annual amortization of the Bailly, N-1 costs allowed herein.

Petitioner proposed to record the costs of the terminated Bailly, N-1 unit in Account 182, Extraordinary Property Losses, with the amortization charged to Account 407, Amortization of Property Loss. Petitioner also proposed that the income tax reduction related to these costs be recorded in Account 283, Accumulated Deferred Income Taxes—Other, and amortized to Account 411.1, Provision for Deferred Income Taxes—Credit, during the periods that charges are made to Account 407. The evidence relating to the accounting treatment is not disputed. The Commission finds that the proposed accounting treatment is proper for accounting and for rate making and is approved.

9. **Petitioner's Operating Results at Present Rates:**

For the twelve months ended September 30, 1981, Petitioner's jurisdictional operating income from its operations as adjusted by Petitioner was:

| | |
|---|---|
| OPERATING REVENUES | $735,939,295 |
| OPERATING EXPENSES AND TAXES | |
| Operating and Maintenance Expenses | 469,089,718 |
| Depreciation and Amortization Expense | 91,951,285 |
| Taxes other than income taxes | 32,920,207 |
| Federal Income Taxes | 39,258,186 |
| State Income Taxes | 3,347,211 |
| Total Operating Expenses and Taxes | 636,566,607 |
| Net Operating Income | $ 99,372,688 |

The Commission's findings on the adjustments which were disputed are as follows:

A. *Sales and Revenue normalization:* The Petitioner made an adjustment to test year sales and revenues and to energy-related expense to reflect a decrease in weather-related revenues in the amount of $581,504. Both UCC witnesses Webb and Brosch proposed elimination of Petitioner's proposed adjustment. Both witnesses agreed that the concept of weather normalization, which recognizes a relationship between temperature and kwh sales, is valid, but they opposed the adjustment proposed by the Company based on the methods used in calculating the adjustment. Petitioner used precisely the same method which we accepted in Cause No. 36394, which had been the recommendation of the then Public Counselor's engineering witness. We find therefore that Petitioner's proposed adjustment, having been determined in a manner consistent with that method approved in Cause No. 36394, should be accepted.

*The Commission would prefer that future weather adjustments be based on more extensive studies.* In its next case Petitioner should be required to undertake a study to determine the most representative weather data sources for its territory. Such a study should be comprehensive and take into account geography, demography, and any special climatic conditions, such as the lake effect.

B. *Additional fuel costs:* The Petitioner adjusted production fuel expense by an addition of $10,617,808 to adjust to a current level of fuel costs. The UCC witness and the Commission Staff Accountant each made an additional adjustment to production cost in the amount of $199,344 to reflect the proposed elimination of the weather normalization adjustment. The Commission has allowed the Petitioner's weather adjustment and therefore the proper amount of adjustment to production fuel expense is $10,617,808.

C. *Transmission expense:* Petitioner proposed an adjustment to *increase* electric transmission expense in the amount of $149,617 to reflect the current level of facilities charges by Consumers Power Company.

The UCC witness proposed an adjustment to *reduce* transmission expense in the amount of $264,328. This amount represents a refund of interest received from Consumers Power Company.

The Commission now finds that both adjustments are appropriate, the net effect of which is a net adjustment of $114,711 to reduce transmission expense.

D. *Maintenance expense:* The Petitioner proposed an increase to maintenance expense in the amount of $698,755 to reflect the exclusion of out-of-period credit to maintenance expense. Commission Staff Accountant Brenner and the UCC witness

each proposed to eliminate this adjustment. Mr. Brenner stated that he believes that if an adjustment of this nature is made at one end of an operating period, a corresponding adjustment should be made at the other end.

The Commission finds Mr. Brenner's argument persuasive and the Petitioner's proposed maintenance adjustment is denied.

E. *Wage and Vacation adjustments:* The Petitioner proposed an adjustment of $13,934,521 to reflect the increase in payroll and vacation costs which result from the terms of Petitioner's labor agreements with its bargaining unit employees. This amount was revised to $11,382,842 by Petitioner's witness Johnson.

Staff Accountant Brenner also proposed an adjustment of $11,382,842. The Consumer Counselor witness proposed an adjustment of $11,006,916, which adjustment did not include a projected cost-of-living adjustment (COLA) to be effective July 1, 1982, or an adjustment to vacation expenses of $493,771.

Staff Accountant Brenner proposed a reduction in the amount of $205,000 to reflect an average of 261 working days for union personnel. The Consumer Counselor witness proposed a similar adjustment in the amount of $187,686.

The Commission finds that it is appropriate to include a COLA adjustment as of

July 1, 1982, and that an average 261-day year is appropriate. The payroll adjustment is allowed in the amount of $11,177,842.

F. *Work stoppage expense:* The Petitioner proposed an adjustment to reduce the amortization of work stoppage expense in the amount of $553,401.

City of Gary witness Palast alleged that the allowance of any amortization of work stoppage costs results in a double collection of supervisory payroll costs during the strike. It is our belief that the witness Palast did not understand the nature of adjustment number 10, Exhibit J-1, which is described at page 13 of witness Johnson's testimony as being "other than labor." The labor costs of the strike were normalized in adjustment number 7, Exhibit J-1, to eliminate the effects of the strike. We find that there is no double recovery with respect to the strike and that adjustment 10 should be allowed.

G. *Pension expense:* Petitioner proposed an adjustment of $554,898 to reflect a decrease in the pension expense applicable to the electric cost of service. This adjustment was based on the 1981 valuation funding recommendation of the Company's actuary, increased for the June 1, 1982 pension base adjustments granted to union employees pursuant to the union contract signed February 1, 1981. The Consumer Counselor witness proposed an additional reduction of

pro forma pension expense of $550,394 because he believed that the June 1, 1982 pension base adjustment was not known, fixed and measurable. The Commission now finds that an adjustment based on an estimate made by an actuary is reliable and that the adjustment should be based on the 1981 valuation funding estimate, increased for the June 1, 1982 pension base adjustment defined in the union contract; the proper amount of adjustment is $554,898 which is hereby approved.

H. *Property Taxes:* The Petitioner, the Commission Staff Accountant, and the Consumer Counselor witness each proposed adjustments to property taxes based on a two-part formula contained in the Indiana State Board of Tax Commissioners' Regulation 19. The adjustments were computed by each party using their respective pro forma operating incomes.

Petitioner and the Staff Accountant used three years' historical income and two years' pro forma income in determining the amount of earnings to be capitalized in computing assessed valuation. The Consumer Counselor witness used five historical years' income for the same computation. The prehearing order in this Cause clearly states that property taxes should be adjusted through September 30, 1983. Petitioner's rates should be established to recover a level of property taxes which will be subject to accrual at September 30, 1983. The substitution of pro forma adjusted income in

computing Petitioner's assessed valuation recognizes the fact that additional revenues produce additional income which in turn increases assessed valuation. This Commission has consistently determined the proper level of property taxes for Petitioner using pro forma income. The evidence in this proceeding is not persuasive to change the practice.

The Staff Accountant and the UCC witness each deducted an equalization allowance of 2.5% in computing their property tax adjustment. In addition, Petitioner and the Staff Accountant used a capitalization ratio of 11%, whereas the Consumer Counselor witness used a capitalization ratio of 11.134%. The rate used by the Consumer Counselor witness is the rate which was used in Cause No. 36394.

Based upon the adjustment to income allowed herein, the equalization allowance utilized by the Staff Accountant and the Consumer Counselor witness, the capitalization ratio utilized by Petitioner and the Staff Accountant, and the substitution of two years' pro forma income, we find that property taxes should be increased in the amount of *$1,247,040*.

I. *Social Security Taxes:* The Petitioner proposed an increase in Social Security taxes in the amount of $910,266 to reflect additional payroll taxes due to the increase in tax base, the increase in tax rate, and increased wages. The Staff Accountant proposed an increase of payroll taxes in the

amount of $843,529 which was based on more recent information pertaining to the Consumer Price Index. The Staff's adjustment agrees with the revised numbers entered into evidence by Petitioner's witness Johnson at the hearings held in March, 1982 in this cause. The Consumer Counselor witness proposed an adjustment of $832,887 of additional payroll taxes which was based on his estimate of labor expense. The Commission now finds that the adjustment should be based on the latest figures which were introduced into evidence and estimates based thereon, and the adjustment to Social Security taxes adopted by the Commission is $843,529.

J. *Gross Income Tax:* The Petitioner, the Staff Accountant and the Consumer Counselor's witness all proposed increases to Indiana Gross Income Tax Expense to reflect the effect of their pro forma revenue adjustments and the decrease in the tax rate to 1.30% effective January 1, 1982. After giving effect to the adjustments to revenue allowed herein and the 1.30% rate change, the proper amount of said adjustment is *$411,031.*

K. *Public Utility Fee:* The Petitioner's witness proposed an addition to the Indiana Public Utility fee in the amount of $702,426 based on pro forma revenues and the statutory rate. The Staff Accountant proposed an addition to the Indiana Public Utility fee of $50,531 based on his pro forma revenues

and the 1981 effective rate. The Consumer Counselor witness proposed a reduction in the Indiana Public Utility fee in the amount of $28,598. After giving effect to the adjustments to revenues allowed herein and the 1981 effective rate, the Commission finds the proper amount of said adjustment to be *$50,162* because the effective rate is the rate at which Petitioner will be charged.

L. *Provision for Coal Inventory Build-up:* Staff Accountant Brenner proposed an adjustment to provide for a buildup of fuel stocks for strike preparedness in the amount of $756,030. This adjustment is consistent with prior orders of this Commission and with this witness' rate-base adjustment of coal inventory to the level of 70 days average burn. The Commission has accepted the 70 day average burn adjustment and therefore also accepts this adjustment.

M. *Interest on Customer Deposits:* The Consumer Counselor's witness proposed an addition to interest expense in the amount of $156,418 as a result of his having recommended deducting customer deposits from the rate base. Because the Commission instead determined that customer deposits should be included in the capital structure, this adjustment is disallowed.

N. *Income Tax Expense:* There was only one objection to Petitioner's method of calculating federal and state income taxes, which calculation was set forth in the evidence of record in this cause. Staff Accountant Brenner proposed an adjustment

to synchronize interest expense for tax purposes. NIPSCO's accounting witness Johnson attempted to calculate interest associated with operations through the use of estimates and projections, as did Utility Consumer Counselor witness Brosch. The purpose of these computations was to properly reflect the interest expense associated with the operations of the Petitioner and to exclude any interest expense associated with construction. We find that Mr. Brenner's interest synchronization approach achieves that purpose in a more precise manner and is consistent with this Commission's past practice of segregating operations and construction activities when determining revenue requirements. Petitioner's pro forma effective federal income tax rate, based on the adjustments allowed, is 25.14% and at the rates authorized herein would be 35.70%.

O. *Gross Revenue Conversion Factor:* The Petitioner proposed a 1.9797 factor for converting the additional required operating income into gross revenues taking into consideration revenue taxes, property taxes, and income taxes. The Utility Consumer Counselor witness used a 1.9544 factor, recognizing only Indiana gross income tax and state and federal income taxes. Based on our findings in this cause, we find that the conversion factor should be 1.9974685. The calculation of the conversion factor is shown in Appendix A.

10. **Revenue Requirements:**

Based upon the adjustments which have been allowed herein, Petitioner's pro forma net operating income is summarized below:

| | (In Thousands) |
|---|---|
| OPERATING REVENUES | $735,939 |
| OPERATING EXPENSES AND TAXES | |
| Operating and maintenance expense | 465,721 |
| Depreciation + amortization expense | 65,628 |
| Taxes other than income taxes | 31,682 |
| Federal Income taxes | 54,455 |
| State income taxes | 6,036 |
| Total Operating Expenses and Taxes | $623,522 |
| Net Operating Income | $112,417 |

As can be seen above, Petitioner's pro forma net operating income amounts to $112,417,000. This net operating income represents a rate of return of 5.85% on the fair value of Petitioner's electric utility property determined in Finding No. 5 to be $1,921,733,000.

The foregoing computed rate of return is less than the 7.5% determined in Finding No. 6 to be a fair rate of return. Accordingly, we find that Petitioner's present rates for electric utility service rendered by it are unjust, unreasonable and confiscatory and are insufficient to provide a fair return on the fair value of Petitioner's electric utility property used and useful for the convenience of the public.

Based on Findings 5 and 6 herein, Petitioner is entitled to net operating income in the amount of $144,130,000, which amount is hereby found

to be a fair return upon the fair value of Petitioner's electric property used and useful and reasonably necessary for the convenience of the public. Accordingly, the Commission finds that Petitioner's rate should be increased to produce $63,346,000 of additional operating revenue and total annual operating revenue in the amount of $799,285,000. The increase in revenues will give rise to increased tax expense and as a result expenses will be $655,155,000, and net operating income will be $144,130,000.

The Commission further finds that Petitioner's proposed rates would produce total electric operating revenues in the amount of $857,373,736 and that said amount is more than the additional revenues herein found to be necessary to produce the herein found fair return upon the fair value of Petitioner's property used and useful for the convenience of the Public. Petitioner will, therefore, be ordered to file with this Commission a new schedule of rates and charges which will provide the operating income herein found to be just and reasonable. (See Finding No. 17 below: Distribution of Rates of Return Among Customer Classes.)

11. **Petitioner's Performance Deficiencies:**

UCC witness Jerry Webb presented testimony about the results of his study of NIPSCO power plant productivity. He testified that NIPSCO has poor power plant productivity compared with the other investor-owned electric utilities (IOUs) operating in Indiana and compared with NIPSCO's historical power plant productivity since 1975.

Appendix A-1 to Mr. Webb's prefiled testimony shows that in 1975, NIPSCO's system-

forced outage rate was below 2.5% and was the lowest of the state IOUs. In 1981, it was above 17.5% and the largest in the state.

Mr. Webb's Appendix A-2 shows that, except for 1976, NIPSCO's system has had a lower percentage of system availability than the other IOUs since 1975. Further system availability was at its lowest point in 1979, followed by improvement in 1980, and a decline again in 1981.

Mr. Webb's Appendix A-3 shows that NIPSCO's heat rate (the number of BTU's required to produce one unit of energy output) has consistently increased (*i.e.*, worsened) since 1976, with slight improvement in 1981. NIPSCO's system heat rate is substantially higher than the other Indiana IOUs. Mr. Webb testified that if NIPSCO could achieve its 1976 heat rate that there would be a substantial savings in fuel costs which he estimated to be $19,000,000.

Mr. Webb recommended that an overall management audit be conducted with special scrutiny being given to poor power plant productivity and the size of the coal inventory.

UCC witness Wayne Lash presented an examination of electric utility performance measures for thirteen companies for a 10-year period. These companies were selected on the basis that their operating characteristics are similar enough to NIPSCO's that it is appropriate to compare their performance with NIPSCO's performance. Five service performance measures, three financial performance measures, eight productivity

performance measures and five labor-related performance measures were selected. The thirteen companies were then compared to generate ratios, percentiles and ranks for the ten-year period.

The analysis showed NIPSCO to be no better than average for any ratio and in general much lower than the average with a seriously declining trend over the ten-year period. Based on this comprehensive analysis Mr. Lash also recommended a management audit.

Mr. Lash also updated the ratio analysis made by Mr. Boyd for Cause No. 36394. The updated analysis continues to show that compared to other Indiana IOUs:

> (a) NIPSCO typically employs a larger number of persons to produce a given number of dollars of net income.
>
> (b) NIPSCO consistently employs the largest number of persons for a given number of kilowatt hours sold. We note here that the utility has a large industrial load involving sales of large numbers of kwh to a few large customers. It is not obvious why a large industrial load requires a larger labor force per unit of energy output. Total salary and wages for operations and maintenance per unit of energy output are correspondingly high.
>
> (c) NIPSCO consistently keeps a significantly larger number of employees in relation to its load on the basis of either average load or an average of monthly peaks.
>
> (d) NIPSCO consistently employs a very large number of persons in relation to the

nameplate capacity of its own generating facilities. That NIPSCO contracts for part of its capacity would perhaps mitigate this large difference in ratios *vis-à-vis* those of other utilities; however, one would expect a correspondingly lower number of production employees for reason of the generation being done outside the utility. The ratio of salary and wages for production to megawatts of nameplate capacity also illustrates very great disparity as against the same ratios for other utilities.

(e) NIPSCO regularly has a high or the highest number of employees per unit of value of investment in physical assets.

(f) NIPSCO consistently has the highest ratio of operation and maintenance salary and wage costs per energy unit available (generating plus purchases, plus or minus net interchange).

Petitioner offered the rebuttal testimony of Daniel J. Falvey of United Research (Petitioner's Exhibit R). Falvey described the management evaluation performed by United Research, United's recommendations to the Petitioner, its subsequent review of the Petitioner's accomplishments responsive to the study, and cited personnel reductions and savings resulting from Petitioner's implementation of United's recommendations. The uncontradicted evidence is that a work stoppage of 242 days commencing June 1, 1980 by bargining unit employees unavoidably detained implementation of recommended measures. Falvey testified that an additional management

audit would be a waste of time and money and would be duplicative of the audit performed by United and the continuing efforts of the Management Systems Control Department created by Petitioner to carry on cost and efficiency controls.

This Commission does not wish to order the Petitioner to waste time or money. However, the Company has failed to improve its performance since the last rate case, when we came to the brink of ordering a management audit. There is substantial evidence in this record which persuades us to order an independent review of Petitioner's operating performance including its fuel management. We find that the Commission should consider said review in a subdocket of this proceeding, and it should be so ordered. The review should be conducted under the supervision of the Commission staff and should be paid for by Petitioner. During the subdocketed proceedings, determinations should be made by the Commission based upon recommendations of the parties upon such matters as the choice of independent consultants and the scope of the operating performance review.

We find that the rates being approved herein in Finding No. 10 should be inseparable from and subject to Petitioner's compliance with all of our determinations and orders herein and in the subdocketed proceedings which should be initiated within 45 days from the date of this Order.

12. **Rulings of the Presiding Commissioner and Administrative Law Judge:**

Evidentiary rulings upon motions made during the course of the proceedings by the presiding

Commissioner and Administrative Law Judge are all hereby affirmed except one. Mr. Frederick Eichhorn, Attorney for Petitioner, objected to UCC Witness Brosch's testimony offered in rebuttal to Staff Accountant Brenner's testimony. Mr. Eichhorn correctly stated that Mr. Brenner was not a witness for any party. In addition this Commission notes that no legal mechanism exists for rebuttal pursuant to the Indiana Code or the procedural rules of the Commission. The Commission therefore finds that it should not hear or consider testimony offered to rebut staff reports, and that Brosch's rebuttal to the staff report should be stricken from the record and disregarded by the Commission.

13. **High-pressure Sodium Vapor Street Lights:**

Mr. David Biela, a City Councilman representing the 3rd Ward of Michigan City, testified concerning his efforts to have NIPSCO establish rates for high-pressure, sodium-vapor street lights. Mr. Biela's study of street lighting has led him to believe there is positive cost-benefit for Michigan City associated with the use of high-pressure, sodium vapor street lighting. UCC witness Webb recommended that NIPSCO should, after doing whatever engineering studies are necessary, file a rate for a 100-watt, utility-owned, high-pressure sodium vapor street lighting system. The new rate as well as any other rates for similar lighting systems deemed appropriate by NIPSCO along with cost-supporting data should be filed for consideration under the Commission's "30-day" tariff consideration proceedings within 180 days from the date of this Order.

14. **Economic Recovery Tax Act of 1981:**

A normalization method of accounting as provided for in the Economic Recovery Tax Act of 1981 was used by Petitioner in calculating its pro forma federal income tax expense and deferred income taxes. We also have used a normalization method of accounting, as defined in that Act, to compute Petitioner's federal income tax expense for ratemaking purposes in compliance with § 168(e)(3)(B) of the Internal Revenue Code. We have also applied § 46(f)(2) of the Internal Revenue Code with respect to Petitioner's investment tax credits.

15. **Proposed Rules and Regulations:**

The Petitioner proposed rules and regulations for electric utility service as set out in Petitioner's Exhibit L-1. There is no dispute regarding Petitioner's proposed rules and regulations. We, therefore, find that Petitioner's proposed rules and regulations should be accepted; they are consistent with the duly promulgated rules and regulations of this Commission with regard to standards of service for electric utilities.

16. **Petitioner's Cost of Service Study:**

UCC engineering witness Webb expressed skepticism concerning the validity of the cost-of-service study conducted by NIPSCO for this Cause. Mr. Webb recommended that in its next rate case NIPSCO should present the results of its cost-of-service study two ways. The first should be done as it was in this Cause; the second should have the production and transmission costs allocated in a manner consistent with NIPSCO's FERC

filings. We find that Petitioner should, at a minimum, comply with this recommendation in its next rate case. Or Petitioner may, in conjunction with its next rate case, present this Commission with a proposal for a different method of conducting its cost-of-service study (before the study has been started). Such a proposal could be submitted at the prehearing conference and the Commission could rule on the proposal in its prehearing order.

17. **Distribution of Rates of Return Among Customer Classes:**

The Order of NIPSCO's last rate case (Cause No. 36394, dated October 7, 1981) contained the following ordering paragraph:

> IT IS FURTHER ORDERED that NIPSCO continue to move to the maximum extent practicable, and consistent with other appropriate and applicable regulatory principles, toward cost-based equalization of rates of return among its major customer classes in its future rate proceedings before this Commission. Petitioner, in requesting an across-the-board increase and in stubbornly defending its position in the proceedings in this Cause, has clearly disregarded the above order of this Commission.

Witness Eisendorfer for Intervenor Bethlehem Steel and witness Phillips for Intervenor Inland Steel Co., National Steel Corporation, (Midwest Steel Division), Jones & Laughlin Steel Inc., and Union Carbide Corp., proposed that there be a general reduction by 50 percent in the disparity in rates of return among classes of service.

UCC engineer witness Webb did not make a specific recommendation concerning what movement should be made towards equalization of rates of return, although he did suggest that such changes should probably be made more gradually in this case than in others because of the questionable validity of the cost-of-service study.

It is clear from the evidence that an across-the-board increase would widen the disparities in rates of return among the different classes of service. We find therefore, that the rates of those classes of service which are providing a greater return than is being earned by the Company as a whole should be increased by a smaller percentage than the rates of those classes of service which are providing a smaller return than is being earned by the Company as a whole.

We find therefore that the following approximate percentage increases will narrow the disparities in rates of return among the different classes of service without causing an abrupt increase in rates for any class of customers.

| Rate Schedules | Percentage Increase |
|---|---|
| 611-Residential | 10.5 |
| 621-Gen. Service-Small | 9.5 |
| 623-Gen. Service | 6.3 |
| 624-Gen. Service-Large | 7.1 |
| 634-Gen. Service | 8.5 |
| 632-Ind. Service | 8.0 |
| 633/635 Ind. Service | 8.6 |
| 651-699 Lighting | 12.5 |
| 641, 623 Public Authority | 8.6 |
| 644-Railroads | 10.5 |

IT IS THEREFORE ORDERED BY THE PUBLIC SERVICE COMMISSION OF INDIANA that an independent review of Petitioner's operating performance including fuel management be conducted. Said review will be conducted under the supervision of the Commission staff and will be paid for by Petitioner. Said review will be conducted in a subdocket of this proceeding. The subdocketed proceeding will be initiated within 45 days from the date of this Order.

IT IS FURTHER ORDERED that the Petitioner be, and hereby is, authorized to increase its rates and charges for electric utility service rendered by it in the territories served by it in the state of Indiana in accordance with Findings No. 10 and 17 of this Order so long as it is in compliance with all findings and orders herein, and specifically those concerning an operating performance review. Said new rates will produce total jurisdictional electric operating revenues of $799,285,000 and on the basis of annual jurisdictional electric operating expenses of $655,155,000 will result in annual jurisdictional electric utility operating income of $144,130,000. Petitioner is hereby authorized to file with this Commission a new schedule of rates and charges which will properly reflect, establish and provide the additional operating income herein found to be just and reasonable as prescribed in Finding No. 17.

IT IS FURTHER ORDERED that Petitioner's annual depreciation rate as proposed is hereby approved.

IT IS FURTHER ORDERED that Petitioner should file for this Commission's approval, at least 30 days prior to the end of the Bailly amortization period, new rate schedules which will be effective the day after the end of said amortization period and will reduce the Petitioner's rates then in effect in an amount equal to the annual revenues then required to provide for the annual amortization of the Bailly, N-1 costs allowed herein.

IT IS FURTHER ORDERED that the Petitioner should, after doing whatever engineering studies are necessary, file a rate for a 100 watt, utility-owned, high pressure sodium vapor street lighting system, as well as any other rates for similar lighting systems deemed appropriate by NIPSCO. The new rates along with cost supporting data should be filed for consideration under the Commission's 30 day tariff consideration proceedings within 180 days from the date of this Order.

IT IS FURTHER ORDERED that NIPSCO move to the maximum extent practicable, and consistent with other appropriate and applicable regulatory principles, toward cost-based equalization of rates of return among its major customer classes in its future rate proceedings before this Commission.

IT IS FURTHER ORDERED that in its next case Petitioner undertake a study to determine the most representative weather data sources for its territory. Such a study should be comprehensive and take into account geography, demography, and any special climatic conditions, such as the lake effect.

IT IS FURTHER ORDERED that Petitioner's proposed rules and regulations are hereby approved.

IT IS FURTHER ORDERED that in Petitioner's next rate case that it improve its cost of service study pursuant to Finding No. 16 herein.

IT IS FURTHER ORDERED that Petitioner be, and it is hereby, authorized to file with the Tariff Division of the Engineering Department of the Commission a new schedule of rates and charges on the basis of and in accordance with the findings herein above set forth, including the rules and regulations applicable to electric service constituting a part of Petitioner's rate schedule, such rates and charges to become effective for all electric service usage from and after the filing thereof by Petitioner and approval thereof by the Engineering Department of this Commission and so long as Petitioner is in full compliance with the findings and orders herein. Such new rates and charges shall be accompanied by a simultaneous refiling of the fuel cost charge approved as of the date of approval of such new rates and charges, modified to reflect the new fuel cost base provided in new rule 39.

IT IS FURTHER ORDERED that the order shall be effective on and after the date of its approval.

**WALLACE, MONTGOMERY AND HARRIS CONCUR.**

APPROVED: September 28, 1982.

I hereby certify that the above is a true and correct copy of the Order as approved.

/s/ L. D. Philpott
L. D. PHILPOTT
Secretary

## APPENDIX A
## NIPSCO REVENUE CONVERSION FACTOR

| | | | |
|---|---|---|---|
| one additional dollar | | | $ 1.00 |
| *less:* gross receipts | | | (.013) |
| PSCI FEE (effective) | | | (.000608622) |
| | | | $ .986391378 |
| *Indiana supplemental income tax* | | | |
| one additional dollar | | $ 1.00 | |
| *less:* gross receipts | | (.013) | |
| PACI fee (effective) | | (.000608622) | |
| additional taxable revenue from $1.00 | | $ .986391378 | |
| tax rate | | 4.0% | |
| amount of additional tax | | $ .03945565512 | |
| *less:* Indiana supplemental | | | (.03945565512) |
| | | | $ .94693572288 |
| *Property tax* | | | |
| one additional dollar | | $ 1.00 | |
| *less:* gross receipts | | (.013) | |
| PSCI fee (effective) | | (.000608622) | |
| Indiana supplemental | | (.03945565512) | |
| | | $ .94693572288 | |
| gross rate | .06988 | | |
| equalization factor | 97.5% | | |
| | .068133 | | |
| percent expensed | 95.955% | | |
| effective rate | ×.06537702015 | | |
| [1-federal tax rate] | | x .54 | |
| amount remaining after fed tax | | $ .51134529035 | |
| effective property tax rate | | x .06537702015 | |
| | | .03343023135 | |

| | | | |
|---|---|---|---|
| one additional dollar of net operating income | $ 1 | | |
| —two years | $ 2 | | |
| —average (divide by 5) | $ .4 | | |
| —capitalized at 11% | $3.63636363636 | | |
| —average (divide by 2) | $1.81818181818 | | |
| —assessment (divide by 3) | $ .60606060606 | | |
| —inverse (1 ÷ assessment) | $ 1.65 | | |
| *add:* | 1.68530359088 | | |
| total | 1.68530359088 | | |
| [1-federal tax rate] | .54 | | |
| effective property tax rate | x .06537702015 | | |
| | .03530359088 | | |
| amount of additional property tax | | ÷1.68530359088 | |
| *less:* property tax | | .01983632594 | (.01983632594) |
| | | | .92709939694 |
| *Federal tax* | | | |
| one additional dollar | | 1.00 | |
| *less:* gross receipts | | (.013) | |
| PSCI fee | | (.000608622) | |
| Ind. supplemental | | (.03945565512) | |
| property tax | | (.01983632594) | |
| additional taxable revenue from $1.00 | | .92709939694 | |
| tax rate | | 46% | |
| amount of additional fed income tax | | .42646572259 | |
| *less:* federal tax | | | (.42646572259) |
| additional net oper. income from one dollar | | | .50063367435 |
| inverse of additional net oper. income (revenue conversion factor) | | | 1.9974685 |

**APPENDIX D**

IN THE
SUPREME COURT OF INDIANA

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No. 1185 S 470

CITIZENS ACTION COALITION OF INDIANA, INC.;
CITY OF GARY; BAILLY ALLIANCE,
*Appellants (Intervenors Below)*,

*v.*

NORTHERN INDIANA PUBLIC SERVICE COMPANY,
*Appellee (Petitioner Below)*,

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Appeal for Review of the
Public Service Commission of Indiana

Cause No. 36689

The Honorable Larry J. Wallace,
William W. Montgomery,
and
Margaret S. Harris, Commissioners

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NOTICE OF APPEAL TO THE
UNITED STATES SUPREME COURT

Notice is hereby given pursuant to Sup. Ct. R. 10 that the appellee Northern Indiana Public Service Company appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of Indiana entered in this action on November 19, 1985, rehearing denied January 3, 1986, construing

Indiana law to preclude the appellee from recovering from its retail customers certain costs of a cancelled nuclear generating plant. This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

EICHHORN, EICHHORN & LINK

By: /s/ Frederick F. Eichhorn, Jr.

FREDERICK F. EICHHORN, JR.
EICHHORN, EICHHORN & LINK
200 Russell Street
P.O. Box 6328
Hammond, Indiana 46325
Telephone: (219) 931-0560
*Attorneys for the Appellee Northern Indiana Public Service Company*

[Filed: Feb. 3, 1986]